CABLE & WIRELESS OPTUS

Cable & Wireless Optus

Submission to the Productivity Commission's

"Review of Telecommunications Specific Competition Regulation: additional matters under reference."

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Executive Summary

This paper is provided to the Productivity Commission in response to the issues paper "Review of Telecommunications Specific Competition Regulation: additional matters under reference", January 2001.

The Cable & Wireless Optus (CWO) submission makes the following points:

- Under present legislative arrangements, a dominant pay TV operator has strong incentives to enter into exclusive arrangements to supply key audience driving pay television programming to their subscriber base, and deprive competitors the ability to show this content to their subscribers. These exclusive programming arrangements can be used by the dominant pay TV provider to hinder and foreclose entry by other infrastructure providers into the delivery of broadband content to consumers via alternative local distribution networks.

- This problem is more acute where the dominant pay TV operator is horizontally integrated into the provision of telephony, internet and other new economy services over its network. Foreclosure of entry into pay TV also protects the dominant operator's earnings in these other monopoly telephony markets.

- Local distribution networks are subject to economies of scale and scope such that entry is more viable where multiple products can be supplied over the network. If important pay TV revenue streams are denied to prospective facilities-based entrants (due to exclusive pay TV programming being locked-up by the dominant operator), the incentives to undertake such new investment are undermined. Therefore, a lowering of competition occurs in both the pay TV industry as well as in the market for these horizontally related products such as telephony, internet and data services.

Such outcomes are not in the public interest for the following reasons:

- Consumers are effectively denied the competitive choice of alternative providers of pay TV services if they wish to obtain access to certain key 'audience driving' content;

- The dominant pay TV operator will be able to continue its present strategy to increase its subscriber base and as a result obtain further key content from program suppliers pursuant to exclusive programming arrangements on terms that smaller pay TV operators cannot compete with;

- In time this will effectively foreclose competition in the pay TV market as rival pay TV operators will not have access to key 'audience driving' content, and thus will be unable to effectively compete;

- Competition in the market for related products such as telephony, internet and data services, will continue to be dominated by the incumbent Telstra and entry will also be effectively foreclosed. This arises because new entrants will be unable to fully realize achievable economies of scope and the benefits otherwise arising from full facilities-based entry and competition will be limited.

- The non-rivalrous nature of pay TV programming means wider distribution of this content benefits consumers and society through improved allocative efficiency. Exclusive programming arrangements for key content narrows the number of consumers that are able to view such high-quality programming; this therefore frustrates the improved distribution of this non-rivalrous content to a wider audience, and the attainment of improved allocative efficiency.

- Exclusive programming arrangements deny consumers access to the full range of high-quality subscription programming unless they subscribe to multiple pay TV networks;

- As effective competition in the pay TV market diminishes, the incentives to undertake facilities-based investment and innovation are undermined. Consumers are therefore denied choice and superior quality new economy services going forward.

The competitive problems discussed above are presently occurring throughout both metropolitan and regional Australia. The dominant telephony monopolist has horizontally integrated into pay TV program supply, and tied-up key content, such as Hollywood movies and premium sports, in exclusive programming arrangements. The denial of this key content to current and prospective facilities-based entrants has raised barriers to entry, and undermined the ability of entrants to undertake facilities-based competition in pay TV and related telephony services throughout Australia. Consumers are effectively denied choice of delivery platforms, choice in providers of service, and diversity in the range of products on offer. Consumers are also denied the competitive benefits associated with the growth in inter-firm rivalry and innovation that accompanies new firm entry —where firms win-over customers by providing “more for less”.

The present *Trade Practices Act (1974)* (TPA*)* is inadequate in dealing with the problem of a dominant pay TV provider entering exclusive programming arrangements that undermine competitive entry. This, is because, among other reasons:

- Evidentiary problems in proving the conduct occurred for a “proscribed” purpose under Section 46 of the TPA;

- Difficulties in proving a substantial lessening of competition under Section 47 of the TPA,

- Temporal problems in obtaining expeditious and adequate remedies under the TPA; for example a monetary damages payment to a litigant from a favorable judgement in a proceeding proving anti-competitive conduct will not compensate consumers for being denied competing distribution platforms to deliver broadband services.

- The Courts will be reluctant to grant the appropriate remedy for a new entrant: non-discriminatory access to the pay TV programming, including the Court determining and specifying a fair and reasonable price of supply.

- The goal of properly constituted Competition Policy is to ***promote*** competition rather than protect what currently exists. Sections 46 and 47 of the TPA are inadequate policy tools for stimulating such competition. An Access Regime or equivalent micro-economic reform, that establishes and enables access to the competitive supply of essential inputs in production, such as audience driving pay TV programming, is required to ***promote*** this goal.

CWO understands similar views, regarding the inadequacies of the TPA in dealing with the competitive implications arising from exclusive program arrangements, are held by the ACCC and various other industry stakeholders.[1]

In recognition of these problems, other jurisdictions have adopted, either by legislative change or specific government intervention, an open programming regime. Such regimes prevent dominant pay TV operators from entering into exclusive programming arrangements that deny alternative distribution platforms access to critical pay TV programming inputs. For example, the United States enacted the *1992 Cable Television Act*. This prevents pay TV operators entering exclusive programming arrangements unless this can be shown to be in the public interest. The *Act* also prevents program owners from entering into agreements that discriminate in their terms of supply of channel content between competing pay TV operators.

In the United Kingdom, *B Sky B* was required by the Office of Fair Trading (OFT) to on-sell key sports such as the Premier League Soccer on fair and non-discriminatory terms to competing Cable companies.

Such government intervention is required in Australia to ensure access to key pay TV programming on fair and non-discriminatory terms to competing infrastructure providers in both metropolitan and regional Australia. CWO supports the introduction of a *Program Access Regime* where:

(1) Pay TV operators are prevented from entering into exclusive programming arrangements unless such contracts can be shown to be in the public interest.

(2) Program suppliers are prohibited from discriminating between competing pay TV operators in the terms of program supply.

Australia, relative to other countries, has a highly concentrated infrastructure market, in the delivery of telephony, data and content services to consumers. This market remains dominated by Telstra. Other Jurisdictions such as the United Kingdom and the United States have historically applied line of business (LOB) restrictions that have prevented the incumbent telephony monopolist from supplying pay TV services. For example, British Telecom had a LOB restriction preventing the direct supply of pay TV services to consumers over the previous decade. Likewise in the United States the Incumbent Local Exchange Carriers (ILECS) were prevented from supplying pay television services and long-distance telephony services to consumers until passage of the *1996 Telecommunications Act*. These historical LOB restrictions provided powerful incentives for cable companies to roll-out their competing local distribution networks over the last twenty years, thereby creating a significantly more competitive infrastructure environment than currently exists in Australia, with the associated benefits to consumers.

The types of program access reforms advocated by CWO are considerably less interventionist than the LOB restrictions that have been adopted in other OECD countries to successfully stimulate facilities-based competition.

In conclusion, without an open program access regime or similar government micro-economic reform, competition in the pay TV market current and prospective competition will rapidly

[1] Submission by Australian Competition and Consumer Commission to the Telecommunications service Inquiry

diminish in both metropolitan and regional centers. The current infrastructure monopoly in Australia, where Telstra dominates the delivery of narrow and broadband information services to consumers, will be further entrenched. Government action facilitating access to key pay TV programming for new entrants is needed to promote and unleash the powerful competitive potential, presently quiescent, of alternative delivery platforms; enabling such platforms to supply high quality, competitive products to consumers.

1. Introduction

1.1. CWO welcomes the opportunity to make this submission to the Productivity Commission's (the Commission) Review of Telecommunications Specific Competition Regulation.

1.2. This submission makes the following points:

- A dominant pay TV operator can tie-up key content in exclusive programming arrangements, thereby minimizing the ability of existing and potential alternative local distribution networks to effectively compete in the pay TV market.
- The problem is exacerbated where the dominant pay TV operator is horizontally integrated into the supply of telephony, internet and other information products, because the incentives to foreclose entry and protect current monopolies from competing local networks are more acute.
- Such conduct is contrary to the public interest because if incentives to invest in competing infrastructures are undermined, the wider distribution of non-rivalrous television content is frustrated. Consumers are denied choice that results from greater competition in products and between service providers.
- The current Trade Practices Act is inadequate in preventing these exclusive arrangements, and thus unlocking competitive forces in an expeditious manner in new industries such as pay television, as well as the market for new interactive, digital services.
- Legislative change, facilitating access to key 'audience driving' pay television programming, is required to promote competition from alternative delivery networks, and will ensure spill-over increases in competition in related products such as telephony, internet and data services.

Without such micro-economic reform, the current incumbent telephony monopolist will further entrench itself as the gatekeeper of narrow and broadband information economy services supplied to consumers.

This submission is set out with the following structure:

What is the problem?

1.3. Chapter 2 discusses the anti-trust problem that arises where the dominant pay Television operator locks-up key programming content in exclusive arrangements that prevent competitors obtaining access to this key input. The discussion is referenced to the practical demonstration of this anti-competitive behavior in Australia, which has limited the incentives and ability of prospective rivals to the dominant pay TV operator engaging in fully effective facilities-based competitive entry.

Why is it a problem?

1.4. Chapter 3 of this submission discusses why the locking up of key programming content in exclusive arrangements is a competitive problem. In particular, it analyses:

- the production function for the delivery of pay TV to consumers and why key programming content is an essential input in this production function;
- the importance of the pay TV revenue stream to the viability of the business cases of prospective competitors undertaking facilities-based entry; and
- why the foreclosing of entry into pay TV, through exclusive content arrangements, diminishes competition in related products also supplied over local distribution networks, such as telephony and internet services.

1.5. The chapter also discusses the dominant monopoly position enjoyed by Telstra in the supply of these services to consumers, and why this monopoly position will be further entrenched if Telstra, as the 50 % owner of the dominant pay TV operator, is able to continue to lockup key programming content.

What is the solution?

1.6. Chapter 4 of this submission discusses the proposed solution to this problem. This involves legislative changes to either the *Trade Practices Act 1974* or the *Broadcasting Services Act*. The changes would prohibit pay TV operators entering into exclusive programming arrangements unless such agreements are shown to be in the public interest. The legislation would also prohibit program suppliers from discriminating between competing pay TV operators on the terms of program supply. Chapter 4 discusses the benefits that would materialize from the introduction of this government micro-economic reform, and how this approach has been successfully adopted in overseas jurisdictions such as the United States and United Kingdom to prevent similar anti-trust problems arising from exclusive programming arrangements. Chapter 4 also discusses why the current TPA may be inadequate in dealing with the anti-trust problems arising from exclusive programming arrangements.

Answers to Productivity Commission questions

1.7. Chapter 5 of this submission responds to a number of issues raised by the Commission in it's issues paper No.2 "Additional matters under reference' and in subsequent discussions with CWO, where those issue are not dealt with in other sections of this submission.

2. The anti-trust problem caused by exclusive programming arrangements

2.1. This chapter discusses the anti-trust problem that arises where the dominant pay Television operator locks up key programming content in exclusive arrangements that prevent competitors obtaining access to this key input. The discussion is referenced to the empirical demonstration of this anti-competitive outcome in Australia, which has limited the incentives and ability of prospective rivals to the dominant pay TV operator to engage in fully effective facilities-based competitive entry.

The anti-trust problem

2.2. In Australia a dominant pay TV operator can enter into exclusive pay TV programming arrangements that prevent competitors supplying this content on their local distribution networks. The market for acquisition of key content is necessarily "thin" or imperfectly competitive, because the dominant pay TV operator can use the buying power associated with having the largest subscriber base to secure key programming from content suppliers on exclusive terms.

2.3. There is an incentive for the dominant pay TV operator to engage in this behavior because by denying competitors access to key content, it places competitors at a serious disadvantage in competing for subscribers. Deprived of key 'audience driving' content, competitors to the dominant operator will lose subscriber numbers; this in turn, negatively impacts on competitors' ability to secure future content that is a viable alternative to that of the dominant operator.

2.4. A self-reinforcing downward spiral results, where lower subscriber numbers on the competitor's network leads to a deterioration in the quality of content able to be secured. This, in turn, results in a further lowering of subscriber numbers on the competitor network. The outcome, if unchecked by pro-competitive anti-trust rules, leads to a monopoly supply of pay TV services to consumers.

2.5. The monopoly outcome in pay TV is also bad for competition in related markets. Local distribution networks can be used to supply multiple products including pay TV, telephony and internet services. Therefore greater economies of scope are achieved by supplying more products over the network. If pay TV is rendered non-viable to competitive entry, due to an inability to secure high–quality content, the economies of scope on the local network are diminished; and the economic viability of the local network roll-out is undermined.

2.6. In addition, if the competitive network is unable to offer the full bundled suite of products on its network, fewer subscribers are likely to individually buy products such as telephony and internet services, if they are unable to also purchase pay Television services within the bundled offering. CWO market data supports the notion that a significant portion of consumers prefer to receive their information/communication services from a single provider. Hence, economies of scope in both production and consumption are reduced if competitive local distribution networks are denied the opportunity to run viable pay TV businesses.

2.7. Furthermore, new entrant fixed networks are subject to economies of density (lower average costs the more subscribers connected within a given geographic area). Hence if fewer subscribers connect to the new entrant network in the local serving area the new entrant will have a higher average cost of service; and will therefore be less cost competitive against the incumbent pay TV/ telephony monopolist.

2.8. The outcome arising from the dominant pay TV operator securing exclusive programming arrangements is not in the public interest for several reasons including:

- Consumers are denied the competitive choice of alternative providers of pay TV service. Competition in related products such as telephony, internet and data services will remain effectively foreclosed. The benefits otherwise arising from full facilities-based entry and competition will be limited.

- Exclusive programming denies consumers access to the full range of high-quality subscription programming unless they subscribe to multiple pay TV networks;

- Incentives to undertake facilities-based investment and innovation are undermined; consumers are therefore denied choice and superior quality new economy services going forward.

- The non-rivalrous nature of pay TV programming means wider distribution of this content benefits consumers and society more generally through improved allocative efficiency. Exclusive programming arrangements for key content reduces the number of consumers that are able to view such high-quality programming; this therefore frustrates the improved distribution of this non-rivalrous content to a wider audience and the attainment of allocative efficiency.

The last of these issues is now discussed.

Programming is non-rivalrous in consumption

2.9. Pay Television programming has the economic characteristic of being non-rivalrous in consumption.[2] That is, consumption by one person does not result in the depletion of the good. For example, the viewing of a television program by one person does not diminish the ability of any one else to view the same program.[3] Similarly, at the wholesale level of the pay TV industry, the broadcasting of a program by one local distribution network does not diminish the ability of any other distribution network to broadcast the same program.

2.10. The non-rivalrous characteristic of TV programming content implies that the marginal cost of supply is close to zero. Therefore, a priori, a wider distribution of such content to consumers promotes economic efficiency because marginal benefit will exceed marginal cost.[4] Subscription fees that consumers pay in return for pay TV services are

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[2] Goods that are price-excludable but non-rivalrous in consumption are sometimes referred to as a toll good. See Pindyck. R and Rubinfeld. D, (1992), Microeconomics 2nd Edition, Macmillan Publishing Company, New York, Pp 661-669.

[3] By contrast, a hamburger is rivalrous in consumption given that once one person eats a hamburger the same hamburger can not be consumed by another person.

[4] Whilst allocative efficiency is maximized by provision of content at close to zero cost, dynamic efficiency necessitates the costs of local distribution networks and the production of content needs to be recouped by subscription fees. This also means the wider the potential Pay TV viewing audience, that is the larger the number of people able to purchase the Pay TV content, the greater the likely level of overall economic

necessary to recoup the fixed costs associated with producing the pay TV content and providing the infrastructure to deliver that content to consumers.

2.11. Marginal benefit, equates to willingness-to-pay. Therefore for goods that are non-rivalrous in consumption, and have close to zero marginal cost of supply, marginal benefit will generally exceed marginal cost. This implies that increases in quantity supplied, associated with a wider potential viewing audience, reduces cost per subscriber, and increases social welfare.

2.12. It therefore follows that exclusive content deals, that effectively reduce the quantity of people who can be supplied with a particular genre of programming, will generally reduce social welfare. This is because sub-optimal quantities of content are delivered to consumers, because certain potential subscribers (where marginal benefits exceeds marginal cost) are denied the opportunity to purchase the content because of the exclusive programming arrangements. Deadweight loss, which would have been avoided by rules preventing exclusive programming arrangements, therefore results.

Program exclusivity outcomes in Australia

2.13. The above discussion outlines the reasons why, if left unchecked, a dominant pay TV operator has incentives to enter exclusive programming arrangements that denies key content to potential competitors, contrary to the public interest. The discussion now turns to the practical demonstration of this outcome in Australia.

Foxtels market behaviour regarding premier sports

2.14. Optus Television has for a considerable period of time attempted, unsuccessfully, to license the FoxSports channels for broadcast on the CWO network. Table 1 details the key sports which are exclusively licensed to FoxSports and therefore denied to CWO:

Key sports exclusively held by FoxSports

US Masters Golf	Wimbledon Tennis	AFL Season 2003 - 2008	Tri Nations Rugby Union	World Motor Cycling Championships	Formula 1 Bikes
US PGA Championship Golf	US Open Tennis	National Rugby League	Bledisloe Cup (Rugby Union)	Australian Touring Car Championship	Daytona 501
British Open Golf	French Open Tennis	State of Origin Rugby League	Super 12 Rugby Union	Indiannapolis 500	Australian Drag Car Racing
Snooker & Pool Competitions	FA Cup Soccer	World Series Baseball	The Australian Indi Cart race	World Super Bike Championship	International Test and One Day Cricket

2.15. International Test and One Day cricket is exclusively broadcast on FoxSports and has not been offered to Optus Television. This indicates that exclusive supply

efficiency. This is because lower per subscriber fees are required to recoup total fixed costs the larger is the size of the total paying viewing audience.

arrangements exist between the Nine network and FoxSports for this output. Common ownership exists between the two companies.[5]

PMP Movie output

2.16. There are two channel suppliers of Hollywood blockbuster movies in Australia: Premium Movie Partnership (PMP) and the Movie Network. PMP is a consortium of Hollywood studios including Columbia, Paramount, Universal and Twentieth Century Fox.[6] PMP produces the Showtime channel and Encore. These channels are both exclusively supplied to Foxtel in metropolitan areas. CWO has sought unsuccessfully to negotiate the carriage of these movie channels on its network. Foxtel's exclusivity arrangements with these movie studios prevent them from supplying their output directly to Optus Television.

Other content

2.17. In addition, to premier sports and PMP, Foxtel presently has exclusive rights over TV1 and certain other channels. CWO has sought unsuccessfully, via negotiations with both the channel providers and Foxtel, to carry these channels on its network. Channel providers approached by CWO have stated that whilst they would very much like their output to be carried by Optus Television their arrangements with Foxtel do not permit this. In a letter to CWO, the CEO of TV1 has indicated that TV1's exclusive arrangements with Foxtel are preventing it from allowing CWO to carry the channel.

Foxtel conduct in relation to the AFL

2.18. Since 1998, Foxtel has consistently refused to licence the C7 sports channels, which would enable Foxtel to carry the AFL.[7] Furthermore, despite consistent attempts by Channel 7, Foxtel has repeatedly denied access to Channel 7 to carry C7 sports channels on the Foxtel network. This issue has been litigated. The full Federal Court found that the ACCC's Part XI C[8] declaration grants Channel 7 access to the Foxtel network. Foxtel is appealing the decision to the High Court. Foxtel has continued to deny Channel 7 access to its pay TV carriage network whilst this litigation continues.

2.19. This strategy pursued by Foxtel suggests that it is motivated to deny its consumers access to the full suite of high-quality content in the short-run in order to establish itself as the monopoly buyer of high-quality content in Australia over the longer term. For example, Foxtel has successfully acquired the future pay TV rights to the AFL, in part, through establishing itself as the only buyer of the rights capable of delivering the AFL to the 673,000[9] strong Foxtel subscriber base. Over the 1998-2001 period, this has denied Foxtel's own pay TV subscriber base the opportunity to watch the highly popular AFL service.

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[5] The Nine Network is a subsidiary of PBL which owns 50% of Fox Sports and 25% of Foxtel

[6] Submission by Australian Competition and Consumer Commission to the Telecommunications service Inquiry Supporting Papers – Australian Pay TV Industry Structure, p2

[7] C7 supplies the AFL to Austar.

[8] The ACCC declared a broadband subscription carriage service on cable networks in 1997 and 1999 under *Part XI C of the Trade Practices Act 1974*.

[9] Sky's the Limit for Chisholm in Foxtel View, The Australian, 18/12/2000, p.33

2.20. To date, the TPA has proved inadequate in providing timely relief to Channel 7 by allowing C7 to supply the AFL to Foxtel subscribers. Foxtel's acquisition of the pay TV rights to the AFL from 2002 to 2006 affords it the future opportunity to initiate a vertical price squeeze against its pay TV (distribution network) competitors in the terms of supply of the AFL to these competitors. In addition, Foxtel may be able to extract pernicious non-price terms and conditions of supply - such as, for example, a requirement to carry Foxtel advertising on the AFL channel.

Recent developments regarding sport

2.21. In the past three months Foxtel has successfully acquired the pay TV broadcast rights to the AFL for the years 2002-2006 and the NRL from 2002 to 2007. This has strengthened Foxtel's position as the monopsony buyer of high quality pay TV content in Australia. The future of the C7 pay TV operation is in doubt following Channel 7's loss of the AFL rights to Foxtel. In addition, and by virtue of its ownership rights over this key 'audience driving' content, Foxtel's ability to control the quality, availability and terms of broadcasting of this critical programming content on competitors' networks has also been strengthened.

2.22. CWO has been able to negotiate with Foxtel to carry the NRL for the next 12 months; however there is no guaranteed future rights of supply of the NRL to Optus Television on non-discriminatory terms. Second, the present agreement between Foxtel and CWO is subject to a number of packaging conditions that CWO would not have otherwise agreed to, but for Foxtel's exclusive programming arrangements.

CWO position

2.23. CWO entered the pay television industry in 1996. In 1999, CWO made all of its arrangements with pay TV programming non-exclusive, including its arrangements with the four major suppliers to the principal movie channels for the CWO pay television platform. These channels collectively known as the "Movie Network channels" include the feature film output of Disney, Warner Brothers, MGM and the Australian distributor Roadshow. CWO purchased the Movie Network channels from June 1999 onwards on a non-exclusive basis. This entitled other pay TV distributors to license the Movie Network channels and deliver them to consumers. When CWO sub-licensed these channels to Austar in 1999, 200,000 of Austar's 350,000 subscribers took the Movie Network channels within 6 months. This demonstrates the popularity of the Movie Network output.

2.24. In relation to Foxtel, supply of the Movie Network channels is conditional on Foxtel making available the Premium Movie Partnership (PMP) channels to CWO. The PMP channels (Showtime and Encore) include the output of the Columbia TriStar, Paramount, Universal and Twentieth Century Fox studios.

2.25. To date, Foxtel has consistently refused to take the Movie Network channels. This has been at the expense of their own consumers who would like to be able to watch these movies — as demonstrated by Austar's subscriber take-up of the service discussed above. It appears that the principal explanation for Foxtel's refusal to take the Movie

Network channels is that it does not want to make the PMP channels available to Optus Television. Foxtel's preference is to deny CWO access to these PMP channels, which appears motivated by anti-competitive reasons, rather than allowing its own subscribers access to a wider choice of movie channels.

2.26. This pattern of behavior, which also occurred in relation to the AFL, suggests that Foxtel's motive is to weaken its competitors including Optus Television, through the use of exclusive programming arrangements, at the expense of providing additional services, such as the Movie Network, to its consumer base.

3.Why is programming exclusivity a problem?

3.1. This chapter discusses the competitive problems associated with the current programming content arrangements in which key content is able to be locked up under exclusive arrangements. In particular, it will outline the structure of the Australian pay TV industry, highlighting the high level of vertical integration. It will also discuss why key programming content is essential for the success of any pay TV service and why the pay TV revenue stream is so important to the viability of broadband networks and facilities based competition. Furthermore, it will discuss why foreclosing entry into pay TV markets, through the use of program exclusivity, diminishes competition in related products that are also supplied over broadband networks. These products include internet, high speed data services and fixed telephony services.

The Market Structure for pay TV and Vertical Integration

3.2. The delivery of pay-TV services to end-users involves a minimum of three essential functions. These functions are:

(a) The retail supply of pay-TV services to subscribers.

(b) The wholesale supply of programming to a pay-TV operator (eg. Foxsports to Foxtel);

(c) The wholesale transmission of pay-TV programming; and

Each of these will be discussed in turn.

The retail supply of pay TV services

3.3. Currently there are three major retail pay TV service providers in Australia. The largest of these is Foxtel, which has approximately 673,000 subscribers. Foxtel has over 50% of the total market share of retail pay TV subscribers. Foxtel's large subscriber base provides the company with market power, in the acquisition of pay TV content relative to its rivals. Foxtel is 50% owned by Telstra, the dominant telephony provider in Australia. It delivers pay television services to most of its subscribers through a broadband cable that has over-built the Optus HFC cable network.

3.4. The next largest retail operator is Austar, which has approximately 420,000 customers. Austar and Foxtel do not compete in the same geographic areas. Austar supplies service in regional Australia other than Western Australia. Foxtel supplies pay TV service in all other (non-Austar) areas including capital cities. Austar also does not compete in its geographic service areas against Telstra in other products such as telephony services. Austar receives much of its quality content, such as the PMP movies and FoxSports, from Foxtel. Austar delivers its service over three different distribution mechanisms: MDS networks in some rural areas, a broadband network in Darwin and Satellite distribution, via the Optus/Austar satellite platform, elsewhere.[10]

[10] Submission by Australian Competition and Consumer Commission to the Telecommunications service Inquiry Supporting Papers – Australian Pay TV Industry Structure, p1.

3.5. Foxtel's only major competitor in metropolitan Australia is Optus Television, which has a subscriber base of 220,000 subscribers and competes for retail subscribers against Foxtel in Sydney, Melbourne and Brisbane. CWO competes against Telstra/Foxtel over the full range of information/communication products including pay television, local and long-distance telephony services, internet (including high-speed internet access into the home), and mobile services.

3.6. In addition to the three retail providers, there a number of smaller start-up or prospective operations, which are either providing or plan to provide bundled services over either broadband cable networks or satellite systems. These smaller operators presently account for less than 40,000 subscribers and include Neighborhood Cable, TransAct, SouthTel, and North Power. The prospective success of their roll-out plans will, in part, depend on their ability to secure high-quality content currently owned by Foxtel.

The wholesale supply of programming

3.7. In order to provide pay TV services retail pay TV operators need to purchase channels from wholesale channel providers who package individual programs into channels, or manufacture the channels themselves from the raw content material. The most important channels are those that package Hollywood Movies and premier sports, as these are the critical drivers of pay TV subscriber numbers. With respect to popular Australian sports there are two channel suppliers in Australia: Seven Cable Television and Fox Sports.[11] Seven Cable Television is a subsidiary of the Seven Network and supplies non-exclusively the C7 channel which is currently broadcast on Optus Television and Austar. C7 has been to offered to Foxtel, but Foxtel has not accepted the offer to broadcast this service. Fox Sports is a 50/50 joint venture between News Limited and PBL, which together own 50% of Foxtel.[12] FoxSports supplies programming to both Foxtel and Austar, who do not compete in the same markets. Despite numerous requests, FoxSports has refused to supply Optus Television. Optus Television does compete directly with Foxtel in Sydney, Melbourne and Brisbane. As discussed above, the future of the C7 business case is in doubt following the loss of pay TV rights to the AFL from 2002 onwards.

3.8. As previously detailed, there are two principal suppliers of Hollywood blockbuster movies: Premium Movie Partnership (PMP) and Movie Network. PMP is a consortium of Hollywood studios including Columbia, Paramount, Universal and Twentieth Century Fox[13]and produces the Showtime and Encore channels. The PMP channels are both exclusively supplied to Foxtel in metropolitan areas.. Movie Network is a consortium of the Disney, Warner Brothers, MGM and the Australian distributor Village Roadshow. Movie Network produces three channels: Movie Extra, Movie One and Movie Greats. These channels are supplied on a non-exclusive basis to Optus Vision.

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[11] Submission by Australian Competition and Consumer Commission to the Telecommunications service Inquiry Supporting Papers – Australian Pay TV Industry Structure, p2.

[12] Submission by Australian Competition and Consumer Commission to the Telecommunications service Inquiry Supporting Papers – Australian Pay TV Industry Structure, Pp2-3

[13] Submission by Australian Competition and Consumer Commission to the Telecommunications service Inquiry Supporting Papers – Australian Pay TV Industry Structure, p2

The wholesale transmission of pay-TV programming

3.9. The delivery of pay TV services to end-users also involves the wholesale transmission of pay TV from a broadcast play out center to a pay TV operator's head-ends. This can be achieved over several different technologies, including[14]:

- Broadband Cable – there are currently four broadband cable networks used to deliver pay TV services in Australia. Telstra operates the largest of these networks. It passes around 2.5 million homes in Sydney, Melbourne, Brisbane, the Gold Coast, Adelaide and Perth. The second largest is Optus Vision, which passes around 2.2 million households in Sydney, Melbourne, and Brisbane. The largest regional cable network passes around 18,000 households in Darwin and is operated by Austar. Neighbourhood Cable also provides a broadband cable network, which passes 5, 200 homes in Mildura.

- Satellite – there are currently two satellites used to deliver pay TV services in Australia. Optus B3 is owned by Optus and is used to transmit the Foxtel and Austar satellite services. PanAmSat-8 is used to transmit TPG's service.'[15]

- MDS- Austar is the only MDS operator in Australia.

Figure 3.1

Retail Distributor	Wholesale Transmission		Wholesale Program Supply	
	Broad Band	**Satellite**	**Sports**	**Movies**
Foxtel Ownership: Telstra: 50% PBL: 25% News Limited: 25%	**Telstra Multimedia** Ownership: Telstra : 100%	**Optus B3** Ownership: Cable & Wirelss Optus: 100%	**Foxsports:** Exclusive Contract: Yes Ownership PBL: 50% News Limited: 50%	**PMP** Exclusive Contract: Yes
Optus Vision Ownership Cable & Wireless Optus	**Cable & Wireless Optus HFC network** Ownership Cable & Wireless Optus	**N/A**	**C7** Exclusive Contract: No Ownership Seven Network: 100%	**Movie One** Exclusive Contract: No
Austar	**Austar Broad Band Cable** Ownership: Austar : 100%	**Optus B3** Ownership: Cable & Wirelss Optus: 100%	**Foxsports:** **C7**	**PMP** **Movie One**

[14] Submission by Australian Competition and Consumer Commission to the Telecommunications service Inquiry Supporting Papers – Australian Pay TV Industry Structure, Pp4-5

[15] TPG currently delivers seven general entertainment channels via PanAmSat-8 satellite as part of its internet access service.

3.10. As detailed in figure 3.1 the pay TV industry in Australia is characterized by a high degree of vertical integration with respect to Foxtel, where wholesale program suppliers and retail pay TV is integrated. This integration has come about through both common vertical ownership and long-term exclusive supply arrangements. For example Fox Sports and PMP are both vertically integrated with Foxtel through both common ownership and exclusive supply arrangements. Furthermore, vertical integration exists between the pay-TV retail distributors and the wholesale transmission of pay TV. Telstra Multimedia, which is 100% owned by Telstra, operates the broadband cable over which Foxtel is delivered. Telstra also owns 50% of Foxtel.

3.11. Telstra is a vertically integrated incumbent that is both a retail supplier of fixed telephony services and has the only ubiquitous fixed telephony network in Australia. Therefore, there is a clear incentive for Telstra to use Foxtel's exclusive content arrangements to foreclose entry into the pay TV market to protect its dominant position in the market for fixed telephony services.

3.12. The ACCC in its submission to the Telecommunications Service Inquiry canvassed the potential for this to occur and its harmful effects on competition:

> "…where there is market power at one of the input levels, vertical integration may be used to hinder or foreclose downstream market entry by denying access to essential inputs such as programming. Alternatively, access may be only given on discriminatory and competitively disadvantageous terms[16]."

The importance of programming

3.13. In order to understand the importance of content to television broadcasting, it is necessary to understand why 'content is king' as well as the monopoly characteristics associated with programming such as premier sports and Hollywood movies.

3.14. As noted by the ACCC in its submission to the Telecommunications Service Inquiry:

> "By its nature, television broadcasting relies on programming content to broadcast. Content is king in the battle of gaining audience shares … and subscriber revenues… Broadcasters must have access to programming of sufficiently high quality to attract economically viable advertising or subscriber numbers[17]."

3.15. In relation to pay TV the ACCC also stated:

> "Pay TV at its most fundamental level is a multi-channel television entertainment and information service that is made available to the general public on payment of subscription fees.

[16] Submission by Australian Competition and Consumer Commission to the Telecommunications service Inquiry Supporting Papers – Competition and Vertical Integration, Pp1

[17] Submission by Australian Competition and Consumer Commission to the Telecommunications service Inquiry Supporting Papers – Telecommunications and the Pay TV Connection, p1

> The multi-channel package is usually built around premium sports and Hollywood movie channels, these being recognized as the drivers of pay TV subscriptions. The package is filled out by a diverse range of specialty or niche channels…[18]"

3.16. The ACCC's comments highlight the fact that key content, in particular Hollywood movies and premier sports, is an essential input for a prospective facilities-based competitor considering entry into the market for pay TV.

3.17. It is also important to recognize that certain programming has uniqueness: a monopoly characteristic in terms of demand side substitutability. A monopoly product is a product for which there are no close substitutes.[19] This can be understood by considering the AFL. AFL is a code of football in which there is a distinctive set of rules, history, teams and players. It also has an established loyal following. A typical AFL fan in Melbourne probably grew up following (and often playing) AFL as opposed to Rugby League or Rugby Union and subsequently many AFL fans have no interest or understanding of alternative codes of football. Therefore, for any typical AFL fan, a game of NRL in which the Brisbane Bronco's plays the Parramatta Eels is unlikely to be a substitute for a Carlton versus Essendon game of AFL. For this reason the AFL is a unique sport for a significant class of consumers and for all effective purposes, cannot be included in the same viewing market as the NRL or Rugby Union due to lack of consumer substitutability.

The importance of sports programming to pay TV

3.18. As already discussed the two key programming genres that drive pay TV subscription levels are Hollywood movies and sports programming.

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[18] Submission by Australian Competition and Consumer Commission to the Telecommunications service Inquiry Supporting Papers – Telecommunications and the Pay TV Connection, p1

[19] Katz M, and Rosen. H, (1991), Microeconomics, Irwin, Boston, p451.

The importance of pay TV to facilities-based competition

3.19. Under the present arrangements, key content such as popular sports and movies are becoming increasingly concentrated under exclusive contracts owned by one distribution platform, namely Foxtel. This means that competing distribution platforms are becoming increasingly disadvantaged in attracting subscribers.

3.20. If going forward Foxtel is allowed to continue to lock up the majority of key content in exclusive deals it will have deleterious long-term consequences on the competitive provision of fixed telephony services such as internet, data services and long distance calls.

3.21. These consequences arise because pay TV plays an important role in the viability of broadband infrastructure investments. These competitive consequences will be the same for both metropolitan and regional Australia. In particular, if competitive pay TV operators are unable to access key content in order to build a viable subscriber base, there will be a disincentive for competing infrastructure providers to offer a bundled product offering including internet, data services, telephony and pay TV services. As the ACCC noted in its submission to the Telecommunication Service Inquiry:

> "Importantly for facilities based competition in regional areas pay TV revenues, multiple revenue streams and bundling strategies and economies of scope underlie…cable rollouts.[20]"

3.22. Program exclusivity by dominant operators undermines the incentives to invest in competing broadband infrastructure. For example, CWO's incentives to roll out a broadband cable in Adelaide will be diminished if it cannot gain access to AFL pay TV programming going forward on fair and non-discriminatory terms and conditions. This concern is shared by Neighborhood Cable a company which is currently rolling out a HFC network in Mildura, as stated in its submission to the Telecommunication Service Inquiry:

> "Broadband network infrastructure needs every revenue stream it can realize in order to be justified, one of these vital revenue streams is pay TV, a revenue stream, unique in the world, currently denied broadband operators.
>
> Quite simply, unless pay TV revenue can be afforded broadband infrastructure operators in regional Australia, the broadband infrastructure which will deliver regional Australia its telecommunications future will not be deployed and the economic future of regional Australians and regional business will be grave.[21]"

[20] Submission by Australian Competition and Consumer Commission to the Telecommunications service Inquiry Supporting Papers – Telecommunications and the Pay TV Connection, p4

[21] Submission by Australian Competition and Consumer Commission to the Telecommunications service Inquiry Supporting Papers – Telecommunications and the Pay TV Connection, p6

The importance of pay TV to competitive local distribution networks

3.23. The competitive viability of alternative local distribution networks depends, in part, on securing pay TV revenue streams. Successful entry into this market around the world, including in the United Kingdom and United States, has relied on the realization of economies of scope via bundled product offerings including pay television and telephony services. For example, CWO is Telstra's major facilities-based competitor in Australia. CWO supplies consumers with a bundled product offering of pay TV, internet, long distance, international and local calls over the HFC network. Successful cable companies in the UK, including NTL and Telewest, have achieved viability by adopting a bundled product entry strategy.

3.24. Local distribution networks are high fixed cost businesses. For example, the cost of the final drop and installation of pay TV hardware in the customer home can be up to $1000 per subscriber. Hence the commercial viability of the local network depends on the ability to achieve economies of scope by supplying multiple products over this network, and earning multiple revenue streams from the supply of these products. This is because the incremental carriage costs of supplying extra products into the home are very low once the network is in place. The incremental costs are less than the revenues earned from the supply of products such as pay TV services. Each extra product added to the local network earns margin that helps fund the fixed costs of the local network. Supplying multiple products makes the business case for competing local networks more viable.

3.25. The deletion of the important pay TV revenue stream from a Competitive Local Network (CLN) offering, as a result of a dominant network locking up key content, would severely impair the future business case of the CLN. This is because fewer subscribers would be attracted to take the bundled product offering of the CLN if pay TV were no longer included. For example, approximately half of all Optus' directly connected HFC subscribers take pay TV services. Therefore, if the CLN no longer offered pay TV services, there would be less revenue and margin derived from customers still remaining on the CLN.

3.26. In addition, new entrant fixed networks are subject to economies of density (lower average costs the more subscribers connected within a given geographic area). Hence if fewer subscribers connect to the new entrant network in the local serving area the new entrant will have a higher average cost of service; and will therefore be less cost competitive against the incumbent pay TV/ telephony monopolist.

3.27. The bundled product network entry strategy is also important in reducing customer churn. For example, CWO market data indicates that those customers who take a bundled set of CWO services are far less likely to churn their individual services, such as local and long distance telephony, to other service providers. To fund the roll out of a cable network, the CLN needs a substantial customer base taking the bundled set of services.

3.28. It follows that the deletion of pay TV services from the CLN, caused by an inability to obtain high quality pay TV channels, would severely jeopardize the continued competitive capability of the CLN in other areas such as telephony and internet services. This is because of a loss of economies of scale, scope and density in production, and a loss of scope economies in consumption.

3.29. It should be noted, with particular reference to current outcomes in Australia, that the concentration of key high quality content within the Foxtel consortium, tied-up in exclusive arrangements, is of major concern to the future competitiveness of the communications industry in general. This is because no matter whether the delivery platform is satellite, cable, digital subscriber loop (DSL) technology etc, access to key content will be critical to any competitor's viability in attracting subscribers to its product offerings.

3.30. The communications infrastructure market is highly concentrated in Australia. There is a substantial risk that if micro-economic reform preventing the misuse of exclusivity arrangements is not put in place there will be a significant reduction in competition in the pay TV market. There will also be a reduction in prospective facilities-based competition. This will also impact negatively on the related communications markets for internet, high speed data services, and fixed telephony services, further entrenching Telstra's dominant position in regard to those services. In time, this will lead to a denial of competitive choice in delivery platforms and access to advanced digital and new economy services, to the detriment of Australian consumers.

4. Benefits of Non Exclusivity.

4.1. This chapter will discuss the following issues:

- why the present *Trade Practices Act* is inadequate in dealing with the problems associated with dominant pay TV operators locking-up key pay TV programming content in exclusive arrangements;

- why implementation of a US style program access regime or similar government micro-economic reform is necessary, and the potential benefits accruing from such reform in both pay TV and related communications markets;

- the anti-trust approaches taken by governments in other jurisdictions to deal with the anti-competitive problems arising from exclusive programming arrangements.

Content Exclusivity and the Trade Practices Act

4.2. The two most relevant sections of the TPA that could theoretically be used to prevent anti-competitive behavior arising from exclusive programming arrangements are[22]:

- Section 46: which prohibits a company from taking advantage of market power for the purpose of eliminating or damaging a competitor, preventing market entry or deterring or preventing competitive conduct.

- Section 47: which prohibits exclusive dealings that have the effect of substantially lessening competition in a market. Broadly speaking, exclusive dealings involve a business imposing restrictions on another's freedom to deal with third parties.

Inadequacy of sections 46 and 47 in providing timely and adequate remedies

4.3. As previously discussed there are several reasons why s.46 and s.47 of the TPA are inadequate in dealing with the anti-competitive problems posed by current exclusive programming arrangements in Australia. First in relation to s.46, there are a number of evidentiary problems in proving that a particular market behavior occurred for a "proscribed" purpose. For example, a particular type of conduct, such as exclusive programming arrangements on critical pay TV content, may have the effect of substantially lessening competition. However, the dominant firm entering the exclusive programming contracts may not have created an evidentiary trial sufficient to prove in a court of law that it had the requisite proscribed purpose under Section 46 of the Act.

4.4. Secondly, there is the problem of delay. Section 46 proceedings will generally take at least two years, and within this time period the anti-competitive conduct of tying-up key content may well result in the elimination of a competitor of the dominant operator. The damages remedy that may eventually arise from successful litigation, and following the exit of the entrant, will provide inadequate restitution for society,

[22] Submission by Australian Competition and Consumer Commission to the Telecommunications service Inquiry Supporting Papers – Competition and Vertical Integration, p3

because they are left with less competition and choice over pay TV/communications service providers.

4.5. Third, there are significant problems with Courts fashioning the correct remedy: access to pay TV programming on fair and non-discriminatory terms including price.[23] This is because it involves the Court taking on the detailed role of setting both the price and non-price terms and conditions of access to essential inputs. Whilst the Courts may grant injunctions requiring parties to deal at previously agreed prices[24], they may be more reluctant to order supply of a product at a specific price where there had been no previous dealings in the product between the parties.[25] Hence, in the circumstance relevant here, where Foxtel has limited, if any, previous dealings with competitors on key content such as the PMP movie output the Courts may be reluctant to fashion the appropriate injunctive relief for new entrants. In addition, a government regulatory body would be more appropriately placed to deal with this aspect of access to essential inputs.

4.6. Delay is also a problem with actions under s.47 of the TPA. Another problem, more particular to s.47, is that it is, in general, not suited to promoting competition where present supply is dominated by a monopoly position. Section 47 is better placed to protect an existing and current level of competition from substantially lessening via use of exclusive dealing provisions.

4.7. In summary, where there is limited competition in an industry, Sections 46 and 47 of the TPA are inadequate policy tools for stimulating desired competition through allowing competitors to obtain access to critical inputs on reasonable terms. Therefore an Access Regime or equivalent micro-economic reform, that establishes and enables access to the competitive supply of essential inputs in production, such as audience driving pay TV programming, is required to **promote** facilities-based competition in alternative mechanisms of supply.

4.8. The ACCC, in its submission to the Telecommunications Services Inquiry, expressed its concern regarding Foxtel's exclusive programming arrangements. However to date the Commission has not taken action against Foxtel under the TPA due to inadequacies in the present Act in being able to provide appropriate and competitive solutions that end the current exclusivity conduct:

> "The Neighbourhood Cable case is not the only incident involving access to programming that has been brought to the ACCC's attention by regional cable operators. Confidentiality prevents the ACCC from discussing these cases but the risk of the foreclosure of regional competition in pay TV and telecommunications is a central concern in them all.[26]"

[23] See "National Competition Policy" (Hilmer Report) August 1993 at Chpater 11 pgs 243, 244 and Chapter 7.

[24] See Maclean v Shell Chemical Australia (1984) APR 40-462 and O'Keefe Nominees v BP Australia ATPR 41- 057.

[25] See Berlaz PTY LTD v Fine Leather Care Products (ATPR) 41- 118. A principal reason for refusing the granting of an injunction was that there was ":no satisfactory explanation of how the court should perform the task of setting prices and other terms of trade".

[26] Submission by Australian Competition and Consumer Commission to the Telecommunications service Inquiry Supporting Papers – Competition and Vertical Integration, p6

4.9. As a final point, it should be noted that access to programming does not fall within the scope of Part XI C of the TPA. Part XI C is concerned with the provision of access to infrastructure used to supply carriage services, in contrast to the present problem that requires competitive access to key programming content.

4.10. In summary, it can be said that the intended purpose of the TPA is to promote competition in markets for the ultimate benefit of consumers. *Part IV* of the Act achieves this goal by prohibiting conduct and mergers that are likely to substantially lessen competition in a market. Accordingly it is inadequate in dealing with issues of promoting competition via non-discriminatory access to key inputs. Access Regimes such as Part IIIA and XI C are the appropriate types of legislative frameworks to deal with such access issues and stimulate competition in areas dominated by a monopoly in supply.

Recommendation

4.11. CWO recommends a Programming Access Regime; this is to facilitate the non-discriminatory supply of key pay TV programming content to facilities-based competitors, presently locked-up under exclusive and monopoly supply conditions. In order to attract investment and encourage facilities based competition within the Australian telecommunications and pay TV industries it is important that rival pay TV service providers can obtain access to key content. This is unlikely to be achieved if it is left to general competition law.

4.12. Access to key programming has not been achieved to date for several operators including CWO, and, we understand, other competitive cable operators such as TransAct and Neighbourhood Cable. In order to promote competition within the pay TV industry, and to ensure the ongoing competitive provision of high quality telecommunication services throughout and metropolitan and regional Australia, alternatives to the current welfare-inferior equilibrium need to be adopted by government. One alternative is implementing a US style Program Access Regime. Such a regime should ensure that:

(a) Prohibit pay TV operators from entering exclusive program supply arrangements unless shown to be in the public interest; and

(b) Prohibit program suppliers discriminating between competing pay TV operators on the terms of program supply.

4.13. Many benefits would flow from such micro-economic reform. First there would be an increase in facilities-based competition in city and regional areas in pay TV. This is because competitive infrastructure providers would no longer be denied the opportunity to earn multiple revue streams from their investments. This would likely lead to positive flow-on benefits in the telecommunications industry in the form of increased competition throughout Australia in the full range of products, including telephony, internet/data services, and alternative delivery platforms. Furthermore, there would be increased consumer choice and ability to obtain diverse and high quality programming from their preferred pay TV supplier. Importantly, consumers would not be required, as is the case now in metropolitan Australia, to sign-up to multiple pay TV service providers to receive the <u>full</u> range of high quality pay TV programming.

4.14. A pay TV Access Regime would increase investment in competitive communications network infrastructure in metropolitan and regional Australia because the return on deployed capital would be greater with the addition of valuable pay TV revenue streams. Hence, an increased facilities-based competition would materialize, stimulating competitive delivery of a range of related broadband and narrowband products such as inter-active TV, internet and data products and telephony services. Australians would benefit from world standard information and entertainment services into the home.

4.15. Further benefits from such microeconomic reform would include increased consumer choice. The reform would also support the growth of small regional players such as TransAct and Neighborhood Cable. Moreover, a US style program access regime would prevent Telstra from eliminating the only other substantive infrastructure competitor in metropolitan Australia – Cable & Wireless Optus

Program access will lead to more rapid deployment of digital technology

4.16. The proposed microeconomic reform would also provide the current pay TV operators with important incentives to economically and efficiently upgrade their existing analogue networks to digital. This is because the marginal revenue product[27] (MRP) of invested capital will be greater if broadband operators can realize enhanced scope economies from the delivery of high quality programming content to the home. As previously discussed, there are scale economies in the delivery of programming into the home such that the incremental resource cost of delivery of additional programs into a home is close to zero[28] (once the home is connected to the network and some programming is being supplied to it). Broadband networks have large fixed costs; therefore access to a greater range of programming enables such networks to achieve greater scale economies, and therefore enhances their revenue potential, viability and returns on future investment such as upgrades to digital technology. [29]

4.17. Current analogue networks will have added incentives to upgrade to a digital capacity network if they have, through program non-exclusivity, access to a greater range of potential programming that can be delivered over the network.

4.18. There is another important reason why firms will more rapidly make the economic decision to upgrade to digital technology if given program access: competition provides rival firms with the incentives to innovate, and provide superior quality products in order to win customers. By contrast, monopolies have uneconomic incentives to reduce the quantity and quality of output supplied in order to maximize profits.[30] Digital television has many benefits over analogue and will deliver new economy services such as high-speed data and internet services. Hence, if a competitor

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[27] This equals the addition to revenue from a one unit increase in deployment of a productive resource such as capital or labor. The MRP of a resource increases the greater the deployment of other resources, such as pay tv programming, within the production function.

[28] This holds up to the point where analogue capacity is exhausted.

[29] In addition, programming is non-rivalrous in consumption; therefore once a program is produced, wider distribution of that program to an audience will generally result in greater economic efficiency.

[30] Monopolists have incentive to undertake economically inefficient quality degradation especially when subject to retail Price Control regulation, such as is the case with Telstra (the 50% share-holder in Foxtel) that is subject to retail price controls in telephony services.

network upgrades to digital technology, Foxtel will, via these competitive pressures, be disciplined to efficiently upgrade its network to digital technology.

4.19. In summary, a Program Access Regime will crystallize in an economically efficient manner current incentives to upgrade current analogue networks to digital technology. Digitisation will allow Australians to benefit from world standard information and entertainment services into the home.

International Experience on Content Exclusivity

4.20. This next section discusses the approach to content exclusivity in other jurisdictions. It shows that Program Access reforms, similar to those recommended by CWO have already been successfully adopted in other countries such as the United States and United Kingdom. Compared to the United States and the United Kingdom, the pay TV industry in Australia is relatively immature. Accordingly, policy-makers here can learn from international developments regarding the success of open program access regimes. The UK Office of Fair Trading was able to deploy the threat of more extensive use of its competition law powers, or enactment of further legislation, to achieve an effective non-discriminatory program access regime. In the US, non-discriminatory program access was achieved more directly by legislative change.

The United States

4.21. In the US prior to 1992, nearly all cable firms enjoyed legally franchised monopolies in the local distribution market. Throughout the 1980's, in response to the termination of monopoly franchise agreements, the cable monopolies often vertically integrated with key major program suppliers, to prevent the successful competitive entry of other operators by denying them access to this key programming.[31]

4.22. Vertical relationships were not limited to integration. As the US Congress noted, during the period 1984-1992, several cable companies required non-affiliated programmers to grant them either exclusive licenses, a financial interest in the programming, or some other consideration if they wanted to be carried on the dominant operator's cable system.[32] Such arrangements were just as effective as vertical integration as they denied rivals access to programming and, in turn, protected the incumbent firms from competitive entry.

4.23. Consequently, new entrants throughout the late 1980's and early 1990s complained they were being denied access to programming controlled by the cable incumbents, through the use of these vertical relationships and exclusive dealing contracts. Even if supply was offered, it was often on discriminatory terms. New entrants also complained that the incumbent cable companies were pressuring independent program suppliers not to supply new entrants.

4.24. In response to the market behavior of the incumbent, aggrieved rivals put forward two basic and related theories under the anti-trust laws. First, some plaintiffs argued that popular programming is an essential facility and that access to this essential facility was

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[31] Annual Assessment of the State of competition in the Market for the Delivery of Video Programming, First Annual Report, FCC 94-235, 28 September 1994.

[32] Olsen. J, and Spiwak. L (1995) Can short-term limits on strategic vertical restraints improve long term cable industry market performance? In Cardozo arts & Entertainment Law Journal, 1995, Vol 13, No.2, p290

being denied to them as an act of monopolization.[33] Section 2 of the Sherman Act prohibits monopolization - its broad equivalent is s.46 of the Australian Trade Practices Act. Second, some plaintiffs argued that the incumbent violated the anti-trust laws by entering into illegal exclusive distribution contracts with popular cable networks.[34] This second argument relates to section 1 of the Sherman Act, which prohibits agreement in restraint of trade. Under the Trade Practices Act, section 1 is broadly equivalent to s.47 of the TPA for the circumstances relevant here.

4.25. Both anti-trust arguments run by new entrants under general Trade Practices Law met with little success. There were two reasons for this:

(1)The essential facilities doctrine as developed by the US courts imposes a high standard as to what is "essential". In the FutureVision Cable case, a cable overbuilder claimed that exclusive dealings contracts with the incumbents were a refusal to deal and therefore in breach of section 2 of the Sherman Act. The court found that the programming in question was not essential, as the overbuilder had access to sufficient programming to allow it to enter the relevant market.[35]

(2) Regarding section 2 of the Sherman Act the US Courts have, under general Trade Practices law, found difficulty in having sufficient evidence to prove an anti-competitive purpose, or to prove the anti-competitive effects of the behavior were sufficient to prohibit the incumbent firm entering the vertical relationships. An exception however was the StorerCable case in which the court found that there were no available substitutes for Sunday Night football which was broadcast exclusively by the incumbent cable providers. Furthermore, the Court found that it was entirely plausible to infer that the exclusive contracts were entered into with the specific purpose of maintaining the incumbent's monopoly.[36]

4.26. Given that action under the Sherman Act met with little success, and that there was growing concern about the market performance of the cable industry and the non-existence of competition, the US congress passed the *Cable Television Consumer Protection and Competition Act 1992*. The *Act* enables access regulation of the price, terms and conditions of pay TV programming services.

4.27. The intention of the 1992 Act was to encourage competition to established cable operators, by ensuring that alternative multi-channel video programming (MVP) distributors had adequate access to programming[37]. Specifically the Act has the following objectives:

[33] Olsen. J, and Spiwak. L (1995) Can short-term limits on strategic vertical restrainsts improve long term cable industry market performance? In Cardozo arts & Entertainment Law Journal, 1995, Vol 13, No.2, Pp. 296 - 300

[34] Olsen. J, and Spiwak. L (1995) Can short-term limits on strategic vertical restrainsts improve long term cable industry market performance? In Cardozo arts & Entertainment Law Journal, 1995, Vol 13, No.2, Pp. 300-305

[35] Olsen. J, and Spiwak. L (1995) Can short-term limits on strategic vertical restrainsts improve long term cable industry market performance? In Cardozo arts & Entertainment Law Journal, 1995, Vol 13, No.2, Pp. 296 - 300

[36] Olsen. J, and Spiwak. L (1995) Can short-term limits on strategic vertical restrainsts improve long term cable industry market performance? In Cardozo arts & Entertainment Law Journal, 1995, Vol 13, No.2, Pp. 300-305

[37] Waterman. D, (1993), Vertical Integration and Program Access in the Cable Television Industry in Federal Communications Law Journal, Volume 47 No. 3, p1. www.law.indiana.edu/fclj/pubs/v47/no3/waterman.html

- to increase competition and diversity in the pay TV industry (both in respect of pay TV operators and program suppliers);

- to increase the availability of pay TV services in rural and other areas not currently able to receive such services; and

- to encourage the development of communications technologies.

4.28. In enacting the regime the US Congress intended not only to foster competition in the market for pay TV services, but also to foster the development of facilities-based competition more generally. As the FCC noted

> "Cable systems have generally developed without effective competition and it is recognized that if facilities-based competition is to develop, access to programming is an essential prerequisite[38]"

4.29. Resulting from the Cable Television Consumer Protection and Competition Act of 1992, the FCC has prohibited the following types of specific conduct:[39]

- A vertically related cable operator shall not unduly influence its related program supplier in relation to supplying other pay TV operators or in setting the price, terms or conditions for each supply.

- A vertically related program supplier shall not discriminate in price terms and conditions of supply between competing pay TV operators, except where there are:

  - Cost differences in the transmission of programming to pay TV operators.

  - Volume differences relative to subscriber numbers

  - Differences in the way in which programs are supplied or marketed

  - Differences in creditworthiness and financial stability

- Vertically related cable operators and program suppliers shall not engage in practices (including exclusive contracts) that prevent a pay TV operator from obtaining programming from the related program supplier for broadcast in areas not served by a cable operator.

- In areas served by a cable operator, vertically related cable operators and program suppliers shall not engage in exclusive contracts unless the FCC is satisfied that such practices are in the public interest.

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[38] Submission by Australian Competition and Consumer Commission to the Telecommunications service Inquiry Supporting Papers –US Program Access, p7

[39] Olsen. J, and Spiwak. L (1995) Can short-term limits on strategic vertical restrainsts improve long term cable industry market performance? In Cardozo arts & Entertainment Law Journal, 1995, Vol 13, No.2, Pp. 307-309

- In served areas, a vertically related cable operator shall not sub-license on the condition that the pay TV operator it sub-licenses to purchases other unrelated programming.

- The price for sub-licensed programming must not be more than the program supplier itself would be permitted to charge.

4.30. To date the policy approach adopted by US policy makers has been successful. As noted by Olsen and Spiwak[40]

> "Given the rapidly evolving nature of the MVPD industry it is an intelligent use of public policy to focus on the dynamic rather than the static efficiencies to promote long term consumer welfare. As market performance, which is the most pragmatic test of a policy's effectiveness, indicates that American consumers are beginning to have the option to choose from more than one provider of delivered multi-channel video programming it therefore appears that program access has been effective public policy to date."

4.31. In addition, the public interest test has given the FCC sufficient flexibility, in certain circumstances, to permit exclusive programming arrangements where such arrangements are likely to increase social welfare— for example, if the programming was unlikely to be produced without the exclusive arrangements. The criteria the FCC are required to consider under the public interest test include the effect of the exclusive programming contract on[41]:

- the development of facilities-based entry in pay TV delivery mechanisms;

- competition from alternative delivery mechanisms;

- the attraction of capital investment to the production and distribution of pay TV programming; and

- the diversity of the available pay TV programming.

4.32. These criteria have allowed the FCC to perform a balancing test in choosing whether to allow or quash certain exclusive arrangements; thereby allowing the open program access regime to be implemented in a more flexible manner that better promotes social welfare.

United Kingdom

4.33. In the U.K the pay TV industry structure involves a single satellite provider, BskyB, competing with local cable companies. The cable companies typically provide a bundled package of telecommunication services and pay TV, where as BSkyB, the dominant pay TV operator in the U.K, only offers pay TV. BSkyB also has a dominant position in the wholesale supply of premium sports and movie programming to the cable operators. It acquired this position through exclusively acquiring long-

[40] Olsen. J, and Spiwak. L (1995) Can short-term limits on strategic vertical restrainsts improve long term cable industry market performance? In Cardozo arts & Entertainment Law Journal, 1995, Vol 13, No.2, P 315

[41] See Section 628 (2) (2) (D) of the 1992 Act.

term rights to key programming, in particular to the movie output of the major Hollywood studios and the Premier League Soccer competition in the early 1990's.[42]

4.34. While BSkyB was prepared to offer its key programming to rival cable operators, complaints regarding the terms and conditions of access emerged from many of these competitors. After investigating these complaints, the UK Office of Fair Trading (OFT) concluded in 1995 that BSkyB possessed monopoly power within the markets for the supply of premium sports and movie programming. After threatening, and in lieu of, more formal government action against BSkyB the OFT accepted the following undertakings[43]:

- BSkyB make available key programming to cable competitors, and charge itself for the supply of such programs on a basis that was no more favorable than that applied to cable operators;
- BSkyB was required to keep separate regulatory accounts detailing this non-discrimination in the price terms and conditions of supply of programming; and
- BSkyB would adopt a wholesale pricing structure that did not excessively encourage the bundling and third line forcing of BSkyB channels into a cable operators' pay TV tiering against its commercial judgement.

4.35. These undertakings were subsequently reviewed and strengthened in December 1996 in response to continued complaints about their operation.

4.36. As noted by the Office of Telecommunications (OFTEL) the use of this government intervention has been crucial in establishing structurally competitive pay TV and telecommunications industries in the UK:

> The ability of high bandwidth networks to exploit the economies of scope between telephony and television has been of central importance to the investment in the UK and the development of competition in telephony and television. Cable companies have made commitments to invest on the basis that they would have this ability and without it there would probably not be a viable UK cable industry.[44]"

> The United Kingdom is now reaping the rewards of this pro-competitive stimulus to facilities-based competition. Cable companies provide competitive alternatives to British Telecom telephony service in over 50 % of UK homes; The largest cable company, NTL, has achieved over 60 % penetration in may of its serviced areas. Cable companies also now account for a greater number of the new telephone connections than BT. In addition, the cable companies provide the full suite of services through their

[42] Submission by Australian Competition and Consumer Commission to the Telecommunications service Inquiry Supporting Papers –Program Access in UK: the BSkyB Case p1

[43] Submission by Australian Competition and Consumer Commission to the Telecommunications service Inquiry Supporting Papers –Program Access in UK: the BSkyB Case p1

[44] Submission by Australian Competition and Consumer Commission to the Telecommunications service Inquiry Supporting Papers –Program Access in UK: the BSkyB Case p2

infrastructure including high-speed internet access and digital Pay Television.

4.37. This chapter has highlighted the inadequacies of Australia's TPA in dealing with the competition issues arising from pay TV content exclusivity. Given these inadequacies CWO recommends the implementation of a US style Program Access Regime that would prevent exclusive programming contracts, unless shown to be in the public interest test. Such a test would enable a balancing of the anti-competitive harms against the potential vertical efficiencies that may arise from exclusive contracts in pay TV programming. The benefits that would result from such microeconomic reform were also discussed. This chapter also examined the approaches adopted by UK and US policymakers when dealing with the anti-competitive outcomes resulting from dominant operators entering into program exclusivity arrangements. In both the US and the UK pro-competitive reform, designed to limit the ability of incumbent firms' exclusively tying-up key content to stifle competitive entry, were implemented. Such changes have resulted in increased investment and competition in these countries.

5.Answers to specific questions from the Productivity Commission

5.1. This chapter responds to a number of issues raised by the Productivity Commission in its issues paper No.2 "Additional matters under reference" and in subsequent discussions with CWO, where those issues are not dealt with in other sections of this submission:

What are current arrangements for obtaining programming for pay TV services? To what extent are they exclusive to particular market participants? What alternatives are there?

5.2. Please refer to chapter 3 of the submission regarding the current arrangements and the extent to which they are exclusive. There are a number of alternatives. The first is to adopt a US style program access regime whereby the regulator is charged with the responsibility of balancing the potential efficiency enhancing characteristics of exclusive contracts and vertical relationships with the barriers to entry that they may create. The approach adopted by US policymakers is discussed in chapter 4 of the submission. It should also be noted that the ACCC has recommended a similar legislative approach for the Australian pay TV industry.

5.3. A second option would be to legislate against exclusive contracts per se, however this may prove to be an inflexible policy in the long run. A third option would be to apply general competition law such as the TPA, however as discussed within chapter 4, this would be an inadequate government response to dealing with present dominant operator/ exclusive program arrangements and its deleterious impacts on competition. In the US the ineffectiveness of the relevant sections of the Sherman Act led policymakers to implement legislative change.

Is exclusive access to pay TV programming by some pay TV services a problem for regional Australia? If so, how big a problem is it?

5.4. The problems arising from the current programming arrangements are discussed throughout the submission, particularly in chapter 3. In short, exclusive content arrangements have the ability to limit the level of competition for retail pay TV services throughout Australia. These same issues arise in both metropolitan and regional areas. Moreover, program exclusivity may undermine the incentives to invest in broadband infrastructure; therefore the development of facilities based competition, and the benefits it creates may not be fully realized. If this problem persists, and is left unchecked by government action, the outcome will likely be a pay TV monopoly in Australia where Foxtel's competitors are foreclosed from the market.

5.5. Furthermore, program exclusivity has the potential to drive Telstra's facilities-based competitors to exit the market. Hence, an even more concentrated monopolistic infrastructure market may develop in the delivery of fixed telephony services to consumers.[45] It is unlikely that such a market structure would provide Telstra with the incentive to upgrade its existing network from analogue to digital. Thus, Australia would fail to reap the full benefits of innovation in the information economy.

What have been the experiences associated with the arrangements for cable TV competition policy in the United States- particularly in a regional context-and what lessons do they have for Australia.

5.6. As discussed in chapter 4 of the submission the enactment of the Cable Television Consumer Protection and Competition Act of 1992 has resulted in increased facilities-based investment, competition and benefits for consumers.

5.7. A number of precedent cases have developed that demonstrate the sophistication of the FCC in employing the public interest test to determine whether particular exclusive programming arrangements promote or reduce social welfare. Two such cases are discussed below:

Time Warner Cable and Court TV:

5.8. A major cable operator, Time Warner Cable, filed for exclusivity regarding the Court TV channel. Time Warner, the parent of Time Warner Cable was the largest investor in Court TV. The only other cable TV provider in Manhattan Liberty Cable, opposed the petition.

5.9. In this case, the FCC found that continued enforcement of Time Warner Cables' exclusive contract with Court TV was not in the public interest because the need for exclusivity did not outweigh the potential anti-competitive effect. This included the ability of Liberty Cable to compete in the Manhattan Market.[46]

New England Cable News:

5.10. New England Cable News (NECN) was a regional news-programming supplier that was 50% owned by Continental Cablevision, a major cable operator. It sought approval to enter into exclusive programming deals with its cable affiliates in six regional areas to produce local news content. In this case, the FCC found that exclusivity was critical in attracting investment and in securing distribution. NECN successfully argued that exclusive distribution would foster diversity and would not adversely affect the development of competition. The FCC held that exclusivity was in the public interest and granted NECN's petition for a period of 18 months.[47]

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[45] Telstra presently has 95% of all directly connected fixed telephony services in Australia. In addition, Telstra accrues, based on current USO eligible revenue calculations, approximately 85% of the total communications revenue in Australia, including local, long-distance and mobile service.

[46] Olsen. J, and Spiwak. L (1995) Can short-term limits on strategic vertical restrainsts improve long term cable industry market performance? In Cardozo arts & Entertainment Law Journal, 1995, Vol 13, No.2, Pp. 313-314

[47] Olsen. J, and Spiwak. L (1995) Can short-term limits on strategic vertical restrainsts improve long term cable industry market performance? In Cardozo arts & Entertainment Law Journal, 1995, Vol 13, No.2, Pp. 312-313

Should the onus of proof that it is in the public interest lie with the regulator or the cable TV operator?

5.11. Shifting the onus of proof to the incumbent operator is an efficient allocation of the evidentiary burden because it places the informational burden on those parties best placed to adduce evidence supporting their propositions. The legislative approach adopted by US policy-makers places the burden of proof onto the party seeking exclusivity. A priori, exclusive programming lessens the potential for facilities-based competition and a wider distribution of content, which, in general, increases social welfare. Hence, unless there is evidence of substantial vertical efficiencies etc, program exclusivity should be disallowed on public interest grounds. Therefore the legal burden should be placed on the party claiming exclusivity (the incumbent). That party who is best placed to adduce evidence supporting either vertical efficiencies or the attraction of investment capital in program production which would not occur absent exclusivity.

5.12. Hence, the US allocation of the legal burden would be superior to the alternative, which would involve a burden on new entrants attempting to adduce evidence disproving vertical efficiencies where they are not best placed to do this. In addition, there are several evidentiary problems associated in proving the intent of market conduct under section 46 of the TPA. Furthermore, there are difficulties in proving a substantial lessening of competition under section 47. If a public interest test is adopted, where the burden is placed on incumbent operators requesting exclusive programming, this will better ensure the balancing of anti-competitive harms against the potential offsetting efficiencies of such tying arrangements.

To what extent would the ACCC proposal concerning an absolute prohibition on exclusive program supply contracts covering territories that are not in the pay TV operator's service area affect options of pay TV operators.

5.13. The same public interest test on content exclusivity should apply throughout Australia. In contrast to the US where there are regional cable operators (previously monopolies), the term "pay TV operator's service area", is largely a meaningless concept in Australia. The dominant pay TV operator Foxtel serves customers nationwide via both cable and satellite with over 200,000 of its subscribers served by satellite. Therefore, Foxtel has an effectively national coverage of the Australian population via its satellite delivery platform. It would be difficult to argue any particular geographic area in Australia was not able to be serviced by Foxtel's national footprint.

What would be the effects of the legislation proposed by the ACCC on the rollout of new services?

5.14. As discussed the proposed adoption of an Access Regime would likely result in the increased rollout of new services, in both metropolitan and regional areas — both presently dominated by Telstra which has over 90% share of directly connected customers in **both** markets. As noted by Olsen and Spiwak, an increase in facilities-based investment has materialized in the US because of the *1992 Cable Act*:

> "…immediately following the enactment of the 1992 Act, wireless cable operators were able to raise about six hundred million dollars from the public financial markets, thus enabling these firms to acquire multiple systems and lay the foundations for the economies of scale currently enjoyed by cable MSO's"

5.15. Furthermore as detailed in this submission CWO is presently considering the roll-out of its broadband cable network in Adelaide.[48] However, the incentives to undertake such investment are lessened whilst Foxtel has tied-up key content on exclusive terms.

What might be the wider impacts of the ACCC's proposal on relevant stakeholders (including content providers, consumers, carriers and carriage service providers) in regional and metropolitan Australia?

5.16. The ACCC's proposal would result in a positive-total sum-gain. As detailed in the submission content providers have expressed to Cable & Wireless Optus that they would welcome the carriage of their programming on alternative networks to Foxtel: therefore content providers would be better off. A clear example of this is TV1 that has said to CWO they would very much like to be carried by Optus Television but their current arrangements with Foxtel prevent this outcome.

5.17. Consumers would be better off because they would be able to get access to the full range of high quality programming whichever pay TV service provider they choose. In addition, key audience driving content such as the PMP movie output would be distributed more widely throughout Australia. In addition, consumers would no longer be denied the competitive benefits associated with the growth of inter-firm rivalry that accompanies new firm entry, where firms win customers over by providing "more for less". Under the ACCC's proposal, consumers would have choice of delivery platforms, choice in providers of service and diversity in the range of services. The benefits resulting from non-exclusivity are discussed more fully through-out the submission.

5.18. Carriers and carriage service providers would also be better off because they would not be competitively denied access to essential audience driving content. This would give them a greater incentive to invest in network infrastructure and compete more vigorously on price and quality. This would create benefits for consumers

5.19. The only party that is likely to lose from the institution of an open programming regime is Telstra. Telstra would face increased facilities-based competition. As a result the rents currently enjoyed by Telstra in telephony, internet and other products would be placed under greater competitive threat from such micro-economic reform.

[48] Optus presently has the head-end, local exchange, and fibre strands (steel wire connections between the electricity poles that support the Broadband cable) of the HFC distribution network in place in Adelaide. The broadband cable itself remains to be rolled out.

Do the proposals have detrimental impacts, and if so, how do these arise and how big are they?

5.20. The experience in the US suggests that there will be no losers, other than dominant incumbents, from the implementation of such a proposal. As Olsen and Spiwak note:

> "Moreover, it is not clear that the program access policy has resulted in a sacrifice of static economic efficiencies… the number of new programming networks has continued to enjoy strong growth. There is even some evidence of new programming tailored specifically for alternative distribution media. For example, DBS has the All News Channel, a joint venture between Viacom Broadcasting Inc and Hubbard Broadcasting Inc, and some wireless operators, though capacity constrained, are differentiating their programming offerings by providing interactive services or a foreign language subscription service. Thus although the program access policy is still in its early stages, there is some evidence that by accelerating the de-concentration of the distribution market, the program access policy may, in fact be improving the performance of both the distribution and programming market."

5.21. In contrast, if the current arrangements are allowed to continue and Telstra's competitors are foreclosed from the market, Australian consumers of pay TV and new economy services will be subject to a more monopolistic market structure.

Is facilities based competition necessary for the provision of pay TV services?

5.22. Yes. The experience of the C7/Foxtel litigation shows the difficulties involved in obtaining carriage access to the Foxtel network. Channel 7 has been trying unsuccessfully since 1998 to carry the AFL on the Foxtel network. Foxtel has contested the ACCC broadband declaration decisions, appealed access decisions to the Federal and High Courts, and is currently contesting C7's access to the network under a Part XI C arbitration.

5.23. Facilities-based competition, where possible, is preferable to access competition over monopoly infrastructure. This is because the former type of competition does not depend on continued regulatory support for its survival. Facilities-based competition also provides competition throughout the product chain, rather than being limited to segments within a vertical production function. Competing infrastructure-providers also have strong incentives to innovate and realize dynamic efficiencies throughout the production chain. Competitors are not limited to the technological and quality choices made by the incumbent at the access (network) level of the market. If Telstra is allowed to drive its major broadband competitors to exit the market, it will face a much weaker incentive to digitalise its network.

5.24. A significant benefit of facilities-based competition is that it will provide the impetus for removal of the current plethora of welfare reducing "monopoly/consumer protection" telephony regulations in existence — such as Retail Price Controls.[49]

[49] These regulations hold the price of basic access over $1 billion below cost according to ACCC cost modeling.

5.25. Therefore, CWO believes facilities-based competition has desirable properties that should be encouraged by government policy. A structuralist model of competition regulation that solely relies on access-based competition over a monopoly set of facilities is unlikely to fully promote competition throughout the entire product space. Even if such a "natural monopoly" model was thought to be a desirable policy goal, the same problems caused by program exclusivity would still arise. There would be limited competition over this monopoly infrastructure if key pay TV content was locked-up in exclusive programming arrangements by the monopoly infrastructure provider.

How important is pay TV to the competitive platform model?

5.26. This question is addressed in detail in Chapter 3 "The importance of pay TV to competitive local distribution networks".