SUPPLEMENTARY SUBMISSION BY FOXTEL TO THE PRODUCTIVITY COMMISION INQUIRY INTO TELECOMMUNICATIONS SPECIFIC COMPETITION REGULATION

The distribution by Pay TV operators of their "branded" retail service on new delivery platforms.

The issue of whether FOXTEL will provide its fully branded service for distribution over third party cable networks is ultimately a commercial decision for FOXTEL. FOXTEL has no problem in principle with this type of arrangement but there are a number of factors that need to be taken into account in the consideration of any such arrangement. Those factors include:

1. FOXTEL believes that it is critical that it is able to offer to its customers the same options on all forms of technology. For example, if FOXTEL is to launch a digital cable service, then FOXTEL's customers who subscribe to the FOXTEL digital service and receive FOXTEL via the Telstra cable, should be offered the same functionality to and from the customer as those on a third party digital cable. The same issue arises in relation to technology upgrades. If this does not occur, the marketing message becomes confused and potentially misleading.

2. Maintaining the integrity of the FOXTEL brand and service is critical, and FOXTEL's viability depends on it delivering to all of its subscribers a consistent product, regardless of where they live or what delivery system they use. So FOXTEL is concerned to ensure that any arrangement with third parties will not in any way diminish the value of the FOXTEL brand. In addition, FOXTEL does not want to make its service available on a third party network where it is clear that the business model is too aggressive and there is a high likelihood that the model will not succeed long term. In this instance, FOXTEL is the party that is left to manage customer disappointment.

3. FOXTEL places great value on its customer management services and customer call centre services which are an important way in which competitors can distinguish their products. Any scenarios where third parties are liasing with FOXTEL customers needs to be carefully considered particularly where the third party is offering a number of other services on the network, some of which may directly compete with the FOXTEL service.

4. Where third parties may want to on-sell FOXTEL in areas where FOXTEL is already providing a service (such as in Canberra where FOXTEL provides a satellite service), it needs to be recognised that FOXTEL has installed its current customer base at a loss and it takes a number of years to recover the full customer costs in respect of each customer. In Canberra, for example, there is a legitimate threat to FOXTEL's business model that current FOXTEL customers will churn across to a third party cable service to receive FOXTEL which will result in greater losses to the satellite business which has already been established at considerable cost. Accordingly, any such arrangement would need to involve some form of compensation to FOXTEL for those costs.

5. FOXTEL does not hold unrestricted cable rights for some of its channels which means a number of the FOXTEL channels can only be broadcast over the Telstra cable network. Any such arrangement will therefore involve a renegotiation with channel providers to ensure consistency of the FOXTEL offerings across all technologies.

6. The use of a third party network requires the use of a third party conditional access system. FOXTEL would need to satisfy itself that the security of the third party system is robust enough to avoid unauthorised access to the channel signals as revenue protection is the most fundamental issue in the subscription entertainment business and signal piracy is a very real issue with which the industry is already dealing.

7. A number of operational issues would need to be resolved including:

   (i) the point at which calls from subscribers are transferred between FOXTEL and a third party provider of FOXTEL;
   (ii) how marketing campaign offers are tracked;
   (iii) training of third party sales staff in FOXTEL product and campaign offers over time;
   (iv) troubleshooting of technical faults on third party equipment;
   (v) complaint management;
   (vi) field management and service calls and the billing of those activities;
   (vii) collection of money owing;
   (viii) which party is responsible for billing;
   (ix) the interfacing of data systems;
   (x) how to synchronise customer and address data between FOXTEL and a third party;
   (xi) development of real time interfaces between FOXTEL systems and third party conditional access systems;
   (xii) handling of programming upgrades and downgrades.

   This list not exhaustive but serves to indicate the complexity of these arrangements and the difficulties associated with implementation.

8. The ability to unbundle channels is impacted by both the economics of such arrangements and contractual restrictions. As discussed in our first submission, FOXTEL subscribers are installed at a loss and FOXTEL needs a subscriber to continue their subscription for a period of time before it actually recovers its costs. FOXTEL would not be able to avoid all costs if it was to use a third party network and it is very difficult to find a business model that supports full cost recovery while offering customers the flexibility of an a la carte menu. As far as FOXTEL is aware, no pay TV operator, even in the established US and UK pay TV markets, offers such options.

   FOXTEL's ability to unbundle channels is also driven by contractual arrangements with its channel suppliers. Many of its channel suppliers require carriage of their channels on the FOXTEL basic service.

Would FOXTEL subscribers of third party cable networks be included against Minimum Subscriber Guarantees in relation to movie channels

Essentially this depends upon the terms of the individual agreements.

Canberra Office
Level 3, Nature Conservation House
Cnr Emu Bank and Benjamin Way
Belconnen ACT 2617
PO Box 80
Belconnen ACT 2616
Telephone 02 6240 3200
Facsimile 02 6240 3399
Melbourne Office
Telephone 03 9653 2100
www.pc.gov.au

PRODUCTIVITY COMMISSION

18 July 2001

Ms Lynette Ireland
FOXTEL
Wharf 8
PYRMONT NSW 2009

Dear Ms Ireland

Pay TV content and regional telecommunications networks

Thank you for your very helpful submission of 13 June.

In submissions to this inquiry on the above matter, two separate questions have arisen.

- The first concerns whether a new pay TV company or cable operator should be able to have access to programming that is subject to exclusive licensing arrangements (the concerns of, for example, SaskTel, Optus and the ACCC).
- The second concerns the distribution by pay TV operators of their 'branded' retail service – whether as a 'bundle' of channels or as individual channels – on new delivery platforms where the platform owners have no desire to enter the pay TV business themselves.

In dealing with the first subject in your submission, you make some important points about the need to protect your brand, differentiate your product and protect copyright. However, it is on the second subject, where those arguments do not appear to apply, that we are now seeking your advice. (You touch on this matter in item iii on page 18 of your submission.)

Your submission mentions that Foxtel sub-licenses two channels, *Showtime* and *Encore*, to Neighborhood Cable (for, we understand, its Mildura network only). But this instance aside, none of Foxtel, Optus or Austar has arranged to distribute their branded retail product over the new, small cable networks. In addition, we are seeking to understand the distinction between sub-licensing to another pay TV company, which then retails that product (as seems to be the case with your channels to Neighborhood Cable) and the situation where a pay TV company is the retailer to customers over an open access network (one that the pay TV company does not itself own). We would not see the latter as being a sub-licensing arrangement.

We understand that Foxtel was part of the pilot TransACT rollout in Canberra, but that it is not providing a Foxtel service over the TransACT cable now being rolled out. While we are aware that most of the new networks are in the very preliminary stages of rollout (or even in the planning stages), there seems to be no indication that any pay TV operator will distribute their branded pay TV product over any of them.

We find it hard to understand this. A new cable network would appear to offer a cheaper means for an established pay TV operator to access a larger number of customers, to generate revenues to offset the significant fixed costs and minimum subscriber guarantees associated with a pay TV business. This would seem to be an important matter for pay TV companies, even in areas like Canberra where Foxtel already supplies via satellite. In the case of Foxtel, our presumption is as follows.

- The up-front costs to Foxtel of taking on a new satellite customer include the cost of acquiring and installing the satellite dish and the set top box, and related connection costs. These costs would be saved if Foxtel were to distribute its full retail service over a new cable network.

- Foxtel would then have greater capacity to ‘unbundle’ channels and price them individually if it wished (something made difficult by the need to bundle to recover the avoidable costs mentioned earlier). In this way, some customers who wanted only one or two channels might take up that option, which could be priced to generate a return to Foxtel (something that would not be the case under satellite provision).

- Foxtel would also have the scope to attract new customers, as a cable rollout would effectively expand the market for pay TV through the economies of scope a cable would offer: people who do not take Foxtel’s satellite product now might become customers were it part of a range of services offered as the cable is rolled out.

- Because Foxtel is sub-licensing to Neighborhood Cable, and because Foxtel was involved in the TransACT pilot (retailing direct?), we are presuming that the customers that are obtained as a result of either of these actions can be included against the minimum subscriber guarantees (MSG) that Foxtel has in relation to its movie channels. Is this correct? If not, how are customers gained by sub-licensing treated in relation to the MSGs, and how would customers gained by distributing yourself over someone else’s infrastructure be treated in relation to the MSGs?

- Against this, it is possible that being on an open access network might depress prices below that applying to your satellite service because of the scope for competition from other pay TV operators who may also choose to distribute over the same cable. However, the scope for adverse price effects would seem to be limited by the fact that you have exclusive access to high quality programming.

Have we understood this correctly, at least in broad terms? If not, can you please advise us? It would be very helpful if you would provide us with a supplementary public submission to this effect (please indicate any sections you want treated as confidential). And if there are any issues arising out of more recent submissions you wish to comment on, please do so.

Thank you again for your involvement in our inquiry.

Yours sincerely

Ralph Lattimore
Assistant Commissioner
Telecommunications inquiry

Tel: (02) 6240 3242