



**HOUSE OF REPRESENTATIVES STANDING
COMMITTEE ON COMMUNICATIONS, INFORMATION
TECHNOLOGY AND THE ARTS**

INQUIRY INTO THE UPTAKE OF DIGITAL TELEVISION

**SUBMISSION BY
SEVEN NETWORK LIMITED**

MAY 2005

**INQUIRY INTO THE UPTAKE OF DIGITAL TELEVISION
MAY 2005**

SEVEN NETWORK SUBMISSION

EXECUTIVE SUMMARY

- The single most effective driver to encourage uptake of digital terrestrial television in Australia would be to permit commercial broadcasters to provide multichannel services. Seven strongly supports the removal of the current restrictions on multichannelling.
- The primary reason for the low uptake of digital television in Australia is the lack of a clear value proposition for consumers.
- Multichannelling is an essential consumer driver to ensure the successful transition from analog to digital terrestrial television (DTT) services.
- The UK has the strongest uptake of digital television in the world. The Freeview digital television service is now in almost 5 million UK homes. Freeview has achieved 19% penetration in only 21/2 years since its launch. By contrast, penetration in Australia is only around 9%, 41/2 years after launch of digital terrestrial television.
- There is strong consumer demand for multichannel services. Research conducted in 2004 showed that the majority of viewers believe there should be more variety and choice on the free-to-air platform. An overwhelming 86% of people support multichannelling.
- Australia is the only major DTT market that has not implemented multichannel services as an integral part of its digital terrestrial television platform.
- The rationale for prohibition of multichannelling services in 1998 to protect the “fledgling pay television industry” is no longer relevant. The pay TV sector has undergone significant growth and restructure since that time, with over 1.5 million subscribers, generating revenues in excess of \$1.2 billion per annum and having become a monopoly industry. The policy justification for the prohibition of multichannel services no longer exists.
- Multichannel services on the DTT platform should be a combination of free and subscription services.
- Subscription services are necessary to ensure a financially viable multichannel platform, particularly given the size of the Australian market.
- The two 7MHz channels of spectrum previously reserved for the provision of datacasting services in each capital city should be allocated for the purpose of multichannelling to allow for future growth in the platform.

- Multichannelling services should not be compulsory for free-to-air broadcasters. The service mix should be dictated by market forces and consumer demand. This will deliver a diverse and sustainable service mix that operates in the best interests of consumers.
- HDTV has not proven to be a driver for consumer uptake and the HDTV quota provisions should be lifted.
- Open standards ensure that all manufacturers and suppliers are able to provide consumer equipment for the Australian market. The resulting competition drives lower prices that are essential to achieve greater uptake.

1. OPTIONS FOR ENCOURAGING DIGITAL UPTAKE

The single most effective driver to encourage uptake of digital terrestrial television in Australia would be to permit commercial broadcasters to provide multichannel services.

The Seven Network strongly supports the immediate removal of the current restrictions on the use of digital broadcast spectrum by commercial free-to-air broadcasters to provide multichannel services.

Four key arguments support this position:

- The current digital television framework is not working. Consumer interest in digital television is low and will not allow for analog switch off in a reasonable period of time
- There is strong consumer demand for DTT multichannel services in Australia
- International experience demonstrates that content choice is a key driver for consumers and will significantly contribute to digital conversion
- The policy rationale for the prohibition on multichannelling no longer exists

Seven made a detailed submission outlining the justification for introduction of multichannel services to the DCITA Multichannelling Review in 2004, which is ongoing. A copy of that submission is annexed for the Committee's information (**Annexure 1**).

1.1 Digital Uptake is Comparatively Low

Free broadcasters have invested heavily in the transition to digital. The rollout of transmission services and the population coverage achieved is the fastest and most effective in the world.¹ Despite this, as noted in the Committee's Background Discussion Paper, the uptake of digital terrestrial television in Australia remains disappointingly low.

Free broadcasters commenced digital services in January 2001. After 4 and a half years of digital transmissions there are at best only 777,000 digital terrestrial television and set top boxes in the market². It should be noted that this represents numbers of units supplied by manufacturers to retailers rather than actual sales and does not take into account any duplication for the number of households that have purchased a digital set top unit for a second or third television set (over 70% of homes have more than one television set)³. At the most optimistic estimate, penetration of digital terrestrial television is around 9% of Australian homes.

It is also worth noting that more than two thirds of Australian homes have more than one television set. This means that in the 7.6 million Australian homes there are approximately 15.2 million television sets. It will be necessary to convert close to all of these sets to digital before we are in a position to implement analog switch-off.

¹ For further information on rollout see the submission from FreeTV Australia to this inquiry.

² The sales of free to view digital tv set top receivers and integrated television sets reached 777,000 units at the end of March 2005 based on sales figures provided to Digital Broadcasting Australia by Infomark and DBA digital tv supplier members

³ Source OzTAM Universe Estimates

Taking the DBA set top box sale figures, only about 4.7% of the total television sets in Australia are digitally enabled. Clearly there is a long way to go to achieve satisfactory levels of digital conversion.

Australian uptake rates compare very poorly with the situation in the United Kingdom where after only 2 and a half years of operation, over 6.38 million digital terrestrial units are in the market. Accounting for a certain number of units bought for use on second sets within the same household, OfCom estimates that the Freeview service is now in over 4.59 million UK homes⁴ or around 19% penetration. Freeview has achieved twice the penetration of Australian digital services in half the time. Digital terrestrial television is the fastest growing television sector in the UK with an increase of 17.3% for Q4 2004 on the previous quarter.

Similarly, around 629,000 subscribers are estimated to have converted to Foxtel's digital service in the 12 month period since its launch in March 2004 and Foxtel is on track to achieve full digital conversion by mid-2006, a period of around 2 years. These figures only serve to highlight the sluggish conversion rate for free-to-air digital. By contrast it took over 3 and a half years for the digital terrestrial platform to approach the 600,000 mark. As with Freeview in the UK, Foxtel's digital marketing has focused heavily on the perception of extra channels and greater choice and has been rewarded with large numbers of subscribers converting to the digital service in record time.

The simple fact is that consumers need a reason to purchase a set top box. While a small number may be interested in widescreen format, improved picture and sound quality, Australians have enjoyed a high quality analog PAL service for many years. Many consumers are satisfied with the quality of their existing television services and see no reason to invest in new equipment in the absence of a clear value proposition providing them with additional benefits.

The current digital framework fails to provide consumers with a sufficiently compelling proposition to make the switch to digital terrestrial services. Take-up rates will remain low until the rules are relaxed to allow broadcasters to offer additional services.

1.2 Consumers Want Multichannelling

Additional content is the only proven driver for consumer interest internationally and in Australia as the Foxtel digitisation project demonstrates. As the most obvious and clearly appreciable benefit to be derived from implementation of digital technology, there is no other major DTT market that has prohibited multichannelling on the digital terrestrial spectrum.

In Australia there is a healthy appetite for increased choice in the digital terrestrial space. In 2004, the Seven Network commissioned research from Crosby Textor to ascertain the attitudes of Australian consumers towards multichannel services. The results showed an overwhelming interest in greater choice and diversity of services. Key findings of the research were:

⁴ OfCom Digital Television Update Q4 2004

- **Free to air television is highly valued particularly for Australian content and first run programming**
- **57% of viewers think there is not enough variety on free-to-air television**
- **81% of people are aware of the transition from analog to digital broadcasting but very few understand what digital can deliver outside of better pictures and sound. Consequently, most saw no hurry to adopt digital television**
- **58% of people are not currently aware of the potential for multichannelling services on the terrestrial platform.**
- **86% of people support introduction of multichannelling**
- **91% of people support free multichannelling**
- **59% of people say they would pay something to receive multichannel services**
- **More content and greater choice is the most compelling reason to support multichannelling**

1.3 No policy rationale to prohibit multichannelling

The rationale for the prohibition on provision of multichannel services by commercial broadcasters was to protect “the fledgling subscription television industry.”⁵

The Government announced that this decision would be reviewed “having regard to developments in the pay TV industry”.⁶

The Australian pay TV industry has undergone significant development and growth since that time. It is no longer a fledgling industry in need of protection having undergone total consolidation, digitisation and both revenue and subscriber growth:

- Pay TV has become a monopoly industry as a result of the Foxtel/Optus Content Sharing Agreement, the acquisition by Foxtel of almost all the available pay TV transponder capacity on the Optus C1 satellite, the demise of TARBS and the restrictions placed on the operations of Austar
- Pay TV has in excess of 1.5 million subscribers and Foxtel is close to reaching the 1 million subscriber mark
- Pay TV generates revenues in excess of \$A1.2 billion annually - more than any commercial TV network
- Foxtel has digitised and is ahead of schedule to break even on this investment and to achieve full digital conversion of subscribers
- Telstra and Optus have been permitted to bundle pay TV with telecommunications offerings
- Pay TV is extremely profitable in Australia despite its claims to the contrary. The majority of revenues are paid to its core program providers and controlling partners News Corp and PBL for the movie and sports channels
- Pay TV is viewed by 1 in 4 Australian households

⁵ Media Release “Digital – A New Era in Television Broadcasting”, Senator the Hon Richard Alston 24 March 1998

⁶ Digital Broadcasting – Questions and Answers (attachment to Media Release “Digital – A New Era in Television Broadcasting” 24 March 1998)

- Foxtel partners News Corp and PBL control all major sports rights, most particularly Australian Rules, Rugby League, Rugby Union and Cricket
- Foxtel also owns and controls all major movie rights through the Premium Movie Partnership (News is part owner of the channel) and the recent Foxtel / Optus deal

After 6 years, pay TV is a far cry from the industry that was supposedly so in need of protection in 1998. The justification given for the prohibition on multichannelling no longer exists. Given the undeniable consumer appeal of multichannel terrestrial services and their role in driving uptake, the restriction should be immediately lifted.

This outcome would also be consistent with regimes in all major international digital terrestrial television markets where multichannelling is an integral part of the platform.

1.4 A successful multichannel offering will require both free and pay services

A successful multichannel DTT platform will require multiple revenue streams, both advertising and subscription based. This is particularly the case in Australia, where the market is small and niche channels have a greater reliance on multiple revenue streams to be sustainable.

Seven believes that there is room for advertiser supported free multichannels on the DTT platform as part of a free/pay service offering. However, it must be recognized that multichannelling's ability to grow the advertising pie or to lead to a significant redistribution of advertising dollars to television is likely to be limited, particularly given the small size of the Australian market.

Figures recently released by OfCom indicate that the balance of television industry finance is shifting. For the first time, subscription revenues have overtaken advertising to become the largest single source of revenues for the television industry in the UK.⁷ To some extent these figures are impacted by the huge licence fee revenues paid to the BBC, which place it in a dominant position in the free-to-air sector not replicated in other markets such as Australia and the United States.

However, the trend towards direct payment models is unmistakable. In the UK, subscription revenues have grown total television revenues by over 11% in real terms since 1998, outstripping growth in other revenue sources.⁸ Increasing DVD and broadband penetration coupled with the growth of PVR technology will place the advertising funded broadcast model under further pressure in coming years.

In a report from PriceWaterhouse Coopers commissioned by OfCom, PwC has predicted little revenue growth for traditional television channels over the next decade.⁹

These developments indicate that diversified revenue streams will be critical in the funding mix for a DTT platform.

⁷ The Communications Market 2004, OfCom

⁸ OfCom consultation paper, page 27

⁹ Economic Analysis of the TV Advertising Market, Report by PriceWaterhouseCoopers commissioned by OfCom, December 2004

The limitations of the advertising funded model have been described by OfCom as follows:

In the advertising funded model, broadcasters are motivated by the need to deliver viewers to advertisers in sufficient numbers, not by satisfying the viewing preferences of different groups of consumers (except when a certain group is particularly attractive to advertisers eg 16-34 year olds). Where spectrum is scarce and there is a limited number of channels, this is likely to cause broadcasters to cluster in the middle ground, depriving viewers of the sort of range and balance they might want.

Even where there are more channels to choose from, the strength of preference that a smaller number of viewers have for a particular programme or range of programmes might not be captured by the price that advertisers are willing to pay to screen it.¹⁰

Given the number of available viewers in Australia, the number of additional channels that can attract an audience of sufficient size to be of interest to advertisers will be self limiting. For example, a particular audience share in the UK or US will deliver a significant number of viewers likely to be of sufficient size to attract advertiser support. A similar share in Australia will be a much smaller number and may only be sustainable through subscription revenue. Starting from a lower population base than either the US or the UK, the number of segments into which the Australian audience can be divided before this point is reached is commensurately reduced.

To the extent that these smaller groups have viewing preferences that diverge from the core audience groups, these viewers may be under-served by advertiser funded channels and can only be accommodated through a direct funding model.

Seven sees a critical role for free multichannels in generating consumer interest in the digital terrestrial platform. This has been overwhelmingly demonstrated by the consumer response to Freeview as opposed to OnDigital. The recent decision by Channel 4 in the UK to move its successful youth channel, E4, from the BSkyB pay package to the Freeview platform shows that free multichannels are commercially viable. Channel 4's decision was based on its calculation that the additional advertising revenue gained by being on a successful free platform available to a mass audience was worth more than the subscription income it was receiving for the channel.

But Australia cannot simply replicate the Freeview service which relies heavily on BBC content and the BBC's high funding base as well as a higher population base for advertiser funded channels. Our DTT platform must be tailored to Australian market conditions and is only sustainable if advertiser funded models are supplemented by subscription services to ensure long term viability.

1.5 Planning for future growth

Experience in the UK would suggest that as a multichannel platform grows in popularity it is important to have the capacity for additional channels. In the first few years, broadcasters could be expected to provide one or two additional channels. This would also be limited by spectrum availability.

¹⁰ OfCom review of public service television broadcasting, Phase 1 Consultation Paper, p71

New channel allocations were recently made available on the Freeview platform and were the subject of extensive competition between hopeful channel suppliers. The slots were ultimately awarded to ITV and Channel 4 who are understood to be paying £5-7 million per annum for each channel. An additional three new slots are expected to be made available later in the year and demand for these is also expected to be high.

ITV has also recently purchased SDN for £134 million, which owns one of the six UK DTT multiplexes, in order to secure its expansion plans for DTT services in future. These developments demonstrate the importance of allowing for future growth in Australia's DTT services.

Free to air broadcasters have the capacity to provide a limited number of additional channels within their existing digital spectrum allocations. Each 7MHz channel allows 19-23 Mbits depending on the technical parameters chosen by the relevant broadcaster. A standard definition channel requires between 4-6 Mbits. On current technology, and assuming no HDTV services were being provided, the existing spectrum allocation to broadcasters would permit 45 channels in each existing 7MHz allocation.

A diagram showing the number of channels that can be provided on existing channel allocations is at **Appendix 2**.

The technical limits on the number of channels raises the issue of the number of channels needed to create a sufficiently robust platform to stimulate consumer demand. International models would suggest that around 25-30 channels, including digital simulcasts of existing analog services is a sustainable model. In order to achieve this, Seven believes that in addition to permitting multichannels on spectrum allocated to FTA broadcasters the two 7MHz channels in each capital city originally intended for datacasting should be mandated for future DTT multichannelling services.

The need for this additional spectrum may be alleviated by developments in compression technology, for example MPEG4 and Windows Media 9, which would considerably increase this capacity. While legacy boxes currently in the market could not receive channels delivered using this technology one option to address this would be to allow new multichannels to adopt new compression techniques but to continue to operate the primary analog simulcast service using current MPEG 2 technology.

In this way it would be possible for each broadcaster to transmit approximately 5-6 channels in addition to the simulcast of the primary service. The timing of the new compression technologies indicates that commercial deployment is imminent. MPEG4 technology is already deployed in many DVD players sold in the Australian market. Material for the USDTV launch indicates that it expects WindowsMedia9 technology will be used. New terrestrial and satellite digital services in Europe have also adopted MPEG4 technology.

It is important that regulatory structures for digital television allow for encouragement and introduction of these new technologies.

2 TECHNOLOGY ISSUES

The critical technical consideration in the provision of multichannel services and indeed for a successful digital terrestrial platform of any kind is the overriding requirement for a common platform used by all operators. It is essential for consumer confidence and credibility in the conversion process that all services use the same technical standards including compression techniques, channel allocation and middleware to support interactive standards. Most importantly, all services on the platform must be able to be accessed by a common set top box. Matters such as interference management and set top box conformance are also important elements in the mix to ensure a reliable and stable platform. These elements would become increasingly important in the delivery and management of a sustainable subscription model.

2.1 Standards

Australia has adopted the DVB-T standard. This is an open standard that is easily available from DVB, based in Geneva. The adoption of open standards ensures that the maximum number of manufacturers can access the necessary technical information to provide consumer equipment to the Australian market. This in turn drives competition and lower prices. The availability of low cost consumer equipment is critical in driving uptake of digital television.

A similar approach has been taken in the adoption of MHP for interactive services. While no MHP equipment is currently available in the Australian market, it is anticipated that when it becomes available, interactivity will enhance the digital television experience.

There has been and continues to be extensive Australian input into the DVB standards through its committee process. This ensures that any requirements peculiar to the Australian broadcasting environment can be communicated to and factored into the ongoing work of DVB.

The majority of manufacturers and suppliers to the Australian market have worked closely with broadcasters to ensure their equipment is suitable for our environment. In a free and horizontal market there will be some suppliers who may bring in unsuitable equipment. However market forces will usually ensure that such equipment has a very limited appeal and ultimately disappears.

Consumer attitudes to replacing and upgrading technology are also changing. This can be seen with mobile phones, PCs, game consoles and audio entertainment units. A similar change in consumer behaviour can be expected with digital terrestrial television equipment particularly as it continues to drop in price.

2.2 Multi-dwelling units

A problem that has been experienced with DTT in Australia is the availability of FTA digital signals in homes in town-house and apartment blocks where the cable reticulation system has unintentionally blocked some or all of the new terrestrial digital channels.

In some buildings the wiring installed allows only for certain services and not others. It is important that regulations are developed to ensure that where cabling is installed in new and existing multi-dwelling units that this allows for the reception of digital terrestrial television.

2.3 HDTV

HDTV has a place in the digital television mix but should not be mandated. The low uptake figures for digital television in Australia demonstrate that it is not a consumer driver.

Seven believes the existing HDTV quota requirements should be lifted. There is a legislative review of this requirement to be conducted by 1 July 2005.

High Definition equipment, particularly displays, is still considerably more expensive than standard definition and is only truly accessible by a small percentage of the population. The majority of consumers with High Definition set top boxes are not able to differentiate between the standard definition and high definition service due to the limited pixel capability of their screens and the high bit rates used for standard definition channels (Australian channels use 6-6.5Mbits compared with 4-5Mbits in many European countries).

Using current technology in Australia, terrestrial HDTV is very marginal in performance due to the limited spectrum available for digital services. Current HDTV services in Australia are provided at around 9-14 Mbits. NHK has stated that the capacity required for a full high quality, minimum artifact HDTV transmission is 22 Mbits. HD services in the United States are also transmitted using 18-19 Mbits.

HDTV and multichannelling can co-exist. However mandated HDTV requirements will impact on the ability of broadcasters to provide commercially viable multichannel services. The amount of spectrum required to provide HD services will preclude simultaneous provision of multichannel services (see **Appendix 2**) particularly while current compression technology remains in use for the platform.

To deliver greater predictability for consumers in the availability of services, it would be preferable for broadcasters to be able to provide a consistent multichannel schedule, particularly in prime time. This is unlikely to be possible while HDTV quotas remain in place. If this were to continue, multichannels would need to be scheduled around HDTV programming thereby reducing their consumer appeal and sustainability.

For this reason, and because there is no appreciable consumer demand for HD services at present, HDTV quota obligations should be removed from the legislation. It should be left to the discretion of broadcasters to provide HDTV or multichannel programming in response to consumer demand. Seven is not seeking to remove HDTV as a transmission technology from the DTT platform. HDTV has a place in the digital television landscape particularly as a production technology (rather than a transmission format).

There is a growing level of HD activity among UK and European program makers. One factor driving this development is the change in program making cost equations. Super 16mm film is widespread throughout Europe for programs that are better suited to the characteristics of film. These include single camera shooting and the ability to provide high resolution picture quality largely used for drama and documentaries.

Modern HD cameras can replicate these advantages as they shoot at 25 or 24 frames per second and the progressively scanned picture is proving acceptable to many producers who would normally use film. HD also offers flexibility from the use

of hour long tapes instead of ten minute film magazines and at a reduced production cost.

There is growing interest in HD transmission in the UK, Europe and the US, but primarily as an additional service feature where the more immediate consumer demand for content choice is already being met rather than as a driver for initial take-up.

HD transmission should be discretionary rather than mandatory. Broadcasters should be able to choose whether to provide multichannels or HDTV services in response to audience preference. Ultimately the consumer will decide and the market will prevail.

2.4 Mandating Digital Tuners

Seven does not support proposals to mandate digital tuners for consumer equipment in Australia because:

- The UK, which is the most successful DTT market in the world in terms of consumer uptake, has considered this issue and decided that it is not advisable at this stage of the consumer cycle (although could possibly be appropriate at a later stage).
- A similar requirement has had no effect on consumer uptake in the United States;
- Strategies to drive uptake should focus first on encouraging consumer response rather than mandating technologies;
- Digital tuners add to the cost of consumer equipment and low cost equipment is vital for uptake; and
- This mechanism could work to disadvantage of low cost equipment suppliers currently in the Australian market who work on high volume low margin sales and would unfairly advantage larger established manufacturing groups. The end result is higher equipment prices.