DCITA MULTICHANNELLING REVIEW

SUBMISSION BY

SEVEN NETWORK LIMITED

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SEVEN NETWORK RESPONSE

EXECUTIVE SUMMARY

- Seven strongly supports the removal of the current restrictions prohibiting the provision of multichannel services by free-to-air broadcasters.

- Multichannelling is an essential consumer driver to ensure the successful transition from analog to digital terrestrial television (DTT) services.

- Multichannelling is pro-competitive and promotes viewer choice.

- 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.

- There is strong consumer demand for multichannel services. The majority of viewers believe there should be more variety and choice on the free-to-air platform and an overwhelming 86% of people support multichannelling.

- Multichannel services on the DTT platform should be a combination of free and subscription services.

- A mix of free and pay multichannel DTT services with a market position between free-to-air and premium pay services is emerging internationally. Additional free channels are an important element in driving digital transition but multiple revenue streams will be essential in establishing a sustainable service offering.

- Subscription services are necessary to ensure a financially viable multichannel platform, particularly given the size of the Australian market. Failure to permit subscription multichannelling will entrench Foxtel as the monopoly subscription service provider and compromise the DTT platform by not enabling a full range of services to be provided.

- Both free and pay multichannel services should be permitted on the existing spectrum allocated to free-to-air broadcasters for digital television. In addition, 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 subscription multichannelling.

- 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 a place in the digital television mix but should not be mandated. There is little consumer demand for HD services at present either in Australia or internationally.

- Multichannel services will have no significant impact on existing free-to-air or pay TV broadcasters . Most importantly, multichannelling is unlikely to affect the ability of free-to-air broadcasters to continue to provide quality programming and meet Australian content requirements. Low cost complementary programming and the ability to target niche advertisers will ensure that programming costs and revenue for primary services of free-to-air broadcasters will remain largely unaffected.

- Multichannel services should only be subject to content regulation in relation to adult and illegal material. Imposing obligations of this kind from the outset would compromise the establishment of digital terrestrial multichannel services by creating unsustainable financial and operational requirements. This policy can be reviewed when the services are established and financially viable.

PROVISION OF SERVICES OTHER THAN SIMULCASTING BY FREE-TO-AIR BROADCASTERS ON DIGITAL SPECTRUM

Introduction

In March 1998 the Government announced its digital television policy to grant existing free-to-air broadcasters a 7MHz channel to allow the transition to digital. One of the restrictions placed on the use of the spectrum was that commercial broadcasters would not be permitted to provide multichannelling or subscription television services in the initial years of digital television.

The rationale for this prohibition was to protect "the fledgling subscription television industry."[1]

The Government announced that this decision would be reviewed "having regard to developments in the pay TV industry".[2]

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
- 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
- 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

These developments unequivocally demonstrate that the policy rationale for prohibiting multichannel and subscription services by commercial free-to-air broadcasters no longer exists.

Accordingly the legislative restrictions on services provided by commercial broadcasters are no longer warranted and should be removed. This outcome would be consistent

[1] Media Release "Digital – A New Era in Television Broadcasting", Senator the Hon Richard Alston 24 March 1998

[2] Digital Broadcasting – Questions and Answers (attachment to Media Release "Digital – A New Era in Television Broadcasting" 24 March 1998)

with regimes in all major international digital terrestrial television markets where multichannelling is an integral part of the platform.

Structure of this Submission

The issues addressed in this submission and the order in which they appear largely follows the structure of the DCITA "Provision of Services Other than Simulcasting by Free-to-Air Broadcasters on Digital Spectrum" Issues Paper, May 2004.

1 Objectives of the *Broadcasting Services Act*

Section 3 of the *Broadcasting Services Act 1992* sets out the objectives intended by parliament to be achieved through the broadcasting regulatory framework. It includes the following objectives:

(a) to promote the availability to audiences throughout Australia of a diverse range of radio and television services offering entertainment, education and information; and

(b) to provide a regulatory environment that will facilitate the development of a broadcasting industry in Australia that is efficient, competitive and responsive to audience needs; and…

(n) to ensure the maintenance and, where possible, the development of diversity…in the Australian broadcasting system in the transition to digital broadcasting.

These policy objectives are not being met by the current digital policy framework in part because of the prohibition on digital terrestrial multichannel services.

Current digital services are in effect limited to simulcasts of the primary channels of the five free-to-air networks. No additional services have emerged and consequently the goal of a diverse range of services has not been met on the digital terrestrial platform.

The use of spectrum to do no more than duplicate services that are already available and for which there is limited consumer demand is inefficient. The digital terrestrial television (DTT) platform is not responsive to audience demand for choice and diversity.

High Definition quotas compound this situation. The same content is provided in three different technical formats but there is little consumer interest in HD.

Nor are the current rules promoting competition principles. Australia is the only major pay television market with a monopoly pay TV platform. In its Report on Emerging Market Structures in June 2003, the ACCC identified the important role DTT multichannelling could play in promoting competition in both the pay TV and free-to-air sectors.

It is also worth noting that no other developed country that has launched DTT has prohibited multichannelling. As a rule, the ability to provide more content more efficiently has been considered one of the most valuable features of the move to digital technology.

Removal of current restrictions on multichannelling would significantly contribute to each of these legislative objectives. Implementation of multichannel capability on the digital terrestrial platform is essential if the free-to-air television industry is to remain relevant, efficient, competitive and responsive to audience needs.

2 Simulcast Requirements

2.1 Should broadcasters be required to transmit a simulcast of their analog services in SDTV?

The Seven Network supports the proposition that broadcasters should be able to provide the services that they consider best meet consumer demand on the spectrum allocated to them for digital broadcasting. This approach will deliver maximum consumer choice and therefore accelerate digital take-up.

The realities of commercial broadcasting will inevitably dictate that while ever digital penetration is not universal, all broadcasters will take a commercial decision to provide a simulcast of their primary analog service as part of their digital service. To do otherwise would undermine the advertising revenue model on which their business is based - delivering mass audiences to advertisers to enjoy a shared experience.

As the analog service will remain for some time the primary source of revenue for a broadcaster it would not be possible to omit it from the digital service offering. Nor would it be practical to broadcast it at a later time or to make minor modifications.

For these reasons Seven does not oppose a continuation of the simulcast requirement. It provides certainty in a public policy context that all consumers will have access to at least one common service. It also ensures consistent application of rules such as Australian content quotas across the analog and digital platforms.

There may be some benefit in allowing broadcasters to discontinue simulcasting when a certain level of household penetration of digital equipment is received. This could act as a catalyst to accelerate the transition to digital by those slow to take up the service and assist the ongoing viability of digital by reducing costs.

2.2 Should broadcasters be allowed to provide HDTV programming that is not a simulcast of their SDTV/analog programming?

As all digital set top boxes must currently be able to receive the standard definition simulcast service, it is not necessary that High Definition programs should be the exact same content as standard definition and analog service components. 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).

It should therefore be a matter for broadcasters to respond to consumer demand in determining the content of the services they provide in addition to the primary SD service that is accessible to all viewers. It should also be a matter for consumers to elect whether to invest in additional receiver and display technology to receive any such additional services. As is currently the case, those who choose not to do so would still receive a full high quality standard definition simulcast of the analog service. The market

would determine whether the best use of HD was to simulcast existing programming, provide it at another time or to broadcast entirely different content.

Such an approach would be a more efficient use of the broadcast spectrum and would be consistent with the policy objectives that underpin the introduction of multichannelling. This policy direction would also stimulate the development of innovative HD program options and accelerate the transition to full digital penetration.

2.3 Should different rules apply to metropolitan and regional broadcasters?

There is no public policy or commercial justification for any regulatory differentiation between metropolitan and regional operations as far as simulcast requirements are concerned other than those already in place to allow for cost, size, timing and complexity of rollout and special requirements in relation to one and two licence markets. To the maximum extent possible, regional viewers should have the same opportunity to obtain additional digital services as those in metropolitan areas.

All regional broadcasters have lodged their implementation plans for digital conversion and this process is well underway. In fact, recent figures published by FreeTV Australia indicate that digital services are now available to 90% of the population. Investment decisions have been made by regional broadcasters on the basis of the current requirements, including that full simulcast obligations would apply including in relation to local content. To alter the rules at this stage would disadvantage those broadcasters who have rolled out their digital transmitters more quickly than others. The inability to deliver local advertising on the new platform would also adversely affect the regional broadcasting business model over time, as a significant proportion of advertising revenue is generated from sales in local sub-markets rather than on an aggregated regional or national market basis.

In the case of multichannel services if the provision of these additional channels was optional, there would be no requirement for regional broadcasters to provide such services until they were financially and technically viable.

2.4 Content regulation issues

These issues are considered in greater detail in section 5 below. However in relation to the simulcast of the analog and digital service, no issues arise if simulcasting continues to be mandated.

In the case of additional multichannel services in regional areas it is unlikely that any additional services in either metropolitan or regional markets could sustain local content requirements particularly in the establishment phases. Such conditions should continue to attach to the primary service only but could be considered for additional services at a later time once these services were established taking into account technical and commercial matters.

3 Multichannelling

3.1 Should commercial FTA broadcasters be allowed to provide extra channels in addition to the SDTV analog simulcast service? If so should there be a restriction on the number of channels?

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 policy rationale for the prohibition on multichannelling no longer exists
- 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

There have been two significant reports on the broadcasting industry conducted over the last five years - the Productivity Commission Broadcasting Inquiry Report in March 2000 and the Australian Consumer and Competition Commission's Report on Emerging Market Structures in the Communications Sector in June 2003. Both have strongly recommended the removal of restrictions on multichannelling by free-to-air broadcasters.

3.1.1 The Policy Rationale for restrictions no longer exists

As noted in the introduction to this submission, the policy rationale for prohibiting multichannel services on the digital terrestrial platform was to protect the "fledgling subscription television industry".

Since 1998, the Australian subscription television industry has undergone significant development and growth. This fact was also noted by the ACCC in the course of its discussion in favour of multichannelling in its Report on Emerging Market Structures[3] where it stated

> *"the market has changed substantially since the prohibition was made. These changes include implementation of the pay TV agreements and the plans to digitize the Foxtel/Telstra HFC pay TV network to provide significantly increased services to end-users."*

As acknowledged by the ACCC, the pay TV industry is no longer in need of protection and multichannelling should be permitted as soon as possible. Competition in the pay TV sector has been a policy objective for the industry since its inception. The Part XIC access regime was intended to deliver competition in the event that the market did not. Competition was contemplated for both analog and digital pay TV. However, competition in the sector has not eventuated despite attempts by more than one entity to enter the pay TV market. Incumbent players have been able to block new entrants and competition through delay and pricing strategies.

[3] ACCC Report on Emerging Market Structures in the Communications Sector, June 2003, page 85.

In fact, the pay television industry is now a monopoly. The ACCC has noted that multichannelling could impose some competitive discipline on the pay TV sector and increase the potential for competition both within the free-to-air sector and between the free-to-air and pay sectors.[4]

The conduct of the Foxtel partners (comprising Australia's three largest media companies News Limited, Telstra and PBL) in recent years has resulted in Foxtel gaining an unassailable position of market dominance and ensured it uncontested exclusive rights to all premium movie and sport product for the platform. For example, Foxtel's partners News and PBL bid for NRL rights funded in part by programming fees from Foxtel and assisted further by the third Foxtel partner Telstra through their acquisition of naming rights to the NRL competition at an agreed value. The NRL is a venture/competition owned 50% by News as a consequence of its Superleague initiative designed to circumvent the anti-siphoning laws and established program rights for Australian rugby league football.

Foxtel also bid for the AFL rights in conjunction with the Nine and Ten Networks assisted further by another shareholder Telstra which acquired internet rights and by yet another shareholder News Ltd which undertook newspaper editorial and other support (to a value accepted by the AFL).

Figures released by Foxtel paint a very positive picture for pay TV. Both News and PBL have reported better than expected figures for their investment in Foxtel following a lift in managed subscribers for the pay television company. Foxtel's churn rate is at an historic low and is continuing to decline. The subscriber growth rate for the year increased by 8.3%, more than twice the pace of total subscriber growth[5].

In addition, only 5% of Foxtel Digital customers are taking the basic package, compared with 20% prior to the introduction of digital. Almost half Foxtel Digital subscribers had taken the top package at year-end. Kim Williams, Foxtel's CEO stated that these results were "dramatically higher than we expected, more than double."[6]

310,000 subscribers have so far converted to the Foxtel digital platform and Foxtel predicts it is on-track to reach its target of full conversion by mid-2006. This two year full conversion period compares favourably with BSkyB which took over three years to achieve full digital conversion. Analysts predict that Foxtel will break even on its digital investment in 2006 outpacing BSkyB which broke even on its digital conversion after 4 years.

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. The restriction should be immediately lifted to permit at least some small element of competition to help reduce the cost to consumers and to give freeTV an opportunity to arrest the decline in its audience share.

[4] ibid

[5] CSFB Media Sector – Australia, 13 August 2004

[6] Australian Financial Review, 16 August 2004, p 49

3.1.2 The Current Rules are not Working

As stated by the Productivity Commission, "given the Government's 1998 decision to proceed with digital television, the main policy issue is the conversion process."[7] In making its recommendation in favour of multichannelling, the Productivity Commission highlighted that a shift of emphasis was required to bring about an equitable and efficient migration to digital transmission:

> "The focus of policy should change from augmenting analog broadcasting with digital to replacing analog with digital. Such a shift is more likely if the legislation provides:
> - Certainty and credibility in the conversion process;
> - ***A role for market forces****[emphasis added]*;
> - Enabling, rather than restrictive regulation; and
> - Clear social and cultural policy objectives."[8]

The current digital rules have not worked. Take-up of digital terrestrial set top boxes in Australia remains disappointingly low. If Australia is to reach the goal of analog switch off in a reasonable timeframe, it is vital that digital television policy provides an incentive for consumers to transition to the digital terrestrial platform.

After almost 4 years there are at best only 400,000 digital terrestrial television and set top boxes in the market[9]. 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)[10]. At the most optimistic estimate, penetration of digital terrestrial television is around 5% of Australian homes.

This compares very poorly with the situation in the United Kingdom where after less than 2 years of operation, the Freeview service is now in over 4 million homes or around 17% penetration.

Similarly, Foxtel's recent announcement that 310,000 subscribers have converted to its digital service in the 4 month period from March to July 2004 and that the company is on track to achieve full digital conversion by mid-2006, a period of around 2 years, only serves to highlight the sluggish conversion rate for free-to-air digital. By contrast it took well over 3 years for the digital terrestrial platform to approach the 300,000 mark. 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

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[7] Productivity Commission Broadcasting Inquiry Report, March 2000, p 234

[8] Productivity Commission Broadcasting Inquiry Report, March 2000, p 242

[9] The sales of free to view digital tv set top receivers and integrated television sets reached 409,000 units at the end of June 2004 based on sales figures provided to Digital Broadcasting Australia by Infomark and DBA digital tv supplier members (DBA Press Release 28 July 2004)

[10] Source OzTAM Universe Estimates

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.

3.1.3 Consumers Want Multichannelling

The desire for 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. **Appendix 1** contains consumer research conducted by 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:

- **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**

The key role of content choice was also highlighted in a recent speech given by Dawn Airey to the ABA Conference 2004 where she stated “viewers quickly grasped that with three competing platforms [cable, satellite and DTT] it was now a buyers market and the platform they wanted was the one that offered them the widest possible choice.”[11]

[11] “What I Saw at the (Digital) Revolution”, address by Dawn Airey, Managing Director, Sky Networks, ABA Conference, 24 June 2004, page 6

3.1.4 International Experience

International trends in DTT deployment increasingly point to the emergence of a market for a mixed free/pay service aimed at a price point and channel offering between traditional free to view services and premium pay TV packages. The consumer proposition is based on being easy to understand and offering a greater level of choice.

DTT services have been launched in the UK, Finland, Germany, Italy, the Netherlands, Spain and Sweden. Launches are planned in Austria, France, Norway, Portugal and Switzerland. In each of these countries multichannelling is an integral part of the service package.

Similarly in the United States, multichannelling by terrestrial broadcasters is beginning to emerge following a resounding lack of interest from consumers in a limited channel, High Definition service.

Appendix 2 contains a report prepared by Spectrum Strategy Consultants that outlines the international experience of digital terrestrial television implementation and the lessons that can be drawn from this experience for the Australian market. It focuses on the United Kingdom which has the most successful digital terrestrial platform in the world.

The clear lesson from the UK, US and European markets is that content choice is the most effective driver for consumer takeup of digital services. As noted above, Australian consumers have also responded to Foxtel's claims of new services on the digital platform (despite the fact that in reality most of these are only either audio and time shifted services).

In the United Kingdom On Digital (which later became ITV Digital) launched in 1998 as a digital terrestrial pay TV service. It collapsed in 2002. OnDigital failed because it attempted to compete head to head with a satellite offering demonstrably superior in terms of number, quality and range of services. It attempted to enter a developed payTV sector with a subscription only offering aimed at a market sector already catered for.

Following the collapse of the ITV Digital service in 2002, the service was replaced by Freeview, a consortium of the BBC, Crown Castle and BSkyB. Freeview provides around 30 television and radio services. All that is required to access the service is a digital television adapter, available from major retail outlets for around £50. The Freeview service is now the fastest growing sector in digital television in the UK having grown 19.5% in Q1 2004.

Freeview has recently been supplemented by the launch of a new low cost pay television service on the DTT platform called Top Up TV. At an up-front cost of £7.99 per month with no minimum contract the new service provides 10 channels. Top Up TV launched in March 2004 and acquired 20,000 subscribers in its first month of operation. It is projected to break even at 250,000 subscribers over a two year period. Currently only those with boxes from the former OnDigital service are able to receive the service but Thomson has recently announced that it will manufacture set top boxes for Top Up TV that will be available through retail outlets in the near future. Boxes are expected to retail for around £60-80.

In recognition of the strong consumer appeal of a mixed free/pay service, this development has been echoed by the recent announcement of BSkyB that it will launch a 200 channel free satellite service. According to Dawn Airey, the new free service will complement the premium subscription service currently being marketed by Sky:

> *"It will enable those viewers who are thinking of going digital but don't yet want to opt to pay a monthly subscription to access some of the 200 free-to-air channels that are available. (But when they want to upgrade, they'll be able to do so with a single call to our gently persuasive subscriber management centre.)"*[12]

Not only is the free/pay combination a compelling consumer proposition, it is also a compelling business model. BSkyB has recently upgraded its subscriber targets to 10 million (excluding Freesat only viewers) by 2010.

In the United States multichannel DTT services have also started to emerge. USDTV launched in Salt Lake City in March 2004 offering a service package of 20-30 channels. USDTV is aiming for a national rollout of its service to 30 cities by the end of 2004. The service retails at $19.95 for 30 channels which are a mix of free to air standard and HD services plus cable channels. "Plug and play" boxes retail at Walmart for $99 and contain a conditional access system. The service is based on a one year minimum contract.

USDTV CEO Steve Lindsley has stated that the ideal behind USDTV is to marry the best of breed from the pay TV and free-to-air business models. "We want to blend them both to provide a variety of revenue streams."[13]

The US model also points to a further issue for free-to-air broadcasters in the digital conversion process, that of recouping conversion costs.

"Digital TV is a big expense for broadcasters around the country," said John Greenwood, station manager at KWBQ in Albuquerque, one of USDTV's broadcast partners. "Here is a mandate to put HD on, but without any revenue opportunity…. Teaming up with USDTV "gives us a chance to begin to break even," Mr. Greenwood said[14].

3.2 Number of Channels

There should be no legislative restriction on the number of channels a free-to-air broadcaster can provide using its spectrum. To do so is technologically determinist and may unnecessarily inhibit technological and commercial innovation. However to some extent the number of channels will be limited by technology. The current allocation of 7MHz of spectrum and the use of MPEG2 compression technology will only permit a limited number of channels to be provided. **Appendix 3** contains a diagram showing the number of channels it is possible to provide on existing channel allocations.

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[12] "What I Saw at the (Digital) Revolution", address by Dawn Airey, Managing Director, Sky Networks, ABA Conference, 24 June 2004, page 7

[13] "Is America Ready for Digital Terrestrial Pay TV?" Ken Freed Jan/Feb 2004

[14] Ellen Sheng Dow Jones Newswires WebReprint Service, 18 May 2004

Other than any requirements to provide asimulcast of the analog channel, the content provided on any additional spectrum should be left to market forces. Restrictions will place arbitrary limits on service offerings, diminish consumer choice and inhibit emergence of commercially viable services in response to consumer demand.

The technical limits on the number of channels does however raise 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 DTT subscription multichannelling services.

3.3 Should there be any restrictions on the content of multichannelling by commercial FTAs?

Outside of the usual prohibitions on illegal and adult material, the content of the relevant services should ultimately be a matter for the consumer to decide. If a service does not work it will not rate and therefore will not survive.

There should be no genre restrictions on channel types. This would only limit viewer choice, commercial and creative innovation and inhibit the success of the platform.

Some consideration will of course need to be given to content related issues such as anti-siphoning, Australian content and classification. These are considered further in section 4 of this submission.

3.4 Should the genre restrictions on national broadcasters be modified?

Seven does not support genre restrictions for either commercial or national broadcasters. So long as a service is consistent with the charter of the relevant national broadcaster, it should be permitted.

Some commentators have expressed concerns that unrestricted multichannelling by national broadcasters may pose a threat to the operations of commercial broadcasters. However, these concerns are in our view unfounded.

Firstly, a significant role for public broadcasters in the development of a successful digital terrestrial platform has been an important element in international services. Public broadcasters, not being dictated to the same extent by commercial concerns, have a greater ability to experiment and provide innovative services on the platform.

Secondly, given the funding constraints of public broadcasters in Australia, the imbalance seen in the UK where the BBC's level of funding could be argued to be distorting the free-to-air market would not be replicated here. The cost of premium channels would be a limiting factor on the nature of services that could be provided by national broadcasters with the result that we would be unlikely to see services directly competing with the primary channels of commercial broadcasters.

3.5 Timing

Multichannel services should be permitted at the earliest possible opportunity, preferably from 1 January 2005.

It is important that if new services are to gain a foothold in the Australian market, that they are introduced while the digital television market is still developing. If left too long existing positions will become entrenched and it will then be very difficult for new services to gain a market.

The impact of delayed market entry in media and communications industries is well recognized. Late entry into a market can result in significant disadvantages in gaining market share. This has been clearly seen in the difficulties encountered by Vodaphone entering the mobile phone market against established players Telstra and Optus and also in the challenges of Echostar in gaining a foothold against DirecTV in the United States.

In Germany the much wider penetration of cable and its use as the basic television distribution medium considerably slowed and indeed stymied the launch of digital television (as evidenced by the Kirch Gruppe's and DF-1's financial collapse and the fact that Premiere is effectively the only premium channel).

3.6 Technical aspects

Minimal additional infrastructure would be required by existing broadcasters for the provision of multichannel services. Most commercial broadcasters have already demonstrated that they have this capability through the provision of video program guides, multiview and enhanced services all of which are multiple program streams. ABC and SBS have both at various times provided multichannel services.

As noted above and in **Appendix 3**, free to air broadcasters have the capacity to provide multiple channels within their existing digital channel allocations.

Each 7MHz channel allows 19-21MBits depending on the technical parameters chosen by the relevant broadcaster. A standard definition channel currently requires between 4-6MBits. On current technology, this would permit 4-5 channels in each 7MHz program stream.

Developments in compression technology, for example MPEG4 and Windows Media 9, 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. A diagram illustrating the manner in which capacity could be allocated using Windows Media9 is at **Appendix 4**.

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 to be available in Q4 2004.

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.

In the case of subscription services, customer management and conditional access and billing systems would be required and would need to be provided for in the business plan of a common platform. Some additional infrastructure may be required in order to transmit subscription multichannels on the additional two 7MHz channels currently available in each capital city.

3.7 Business model for multichannelling

Analysis of a business case for multichannelling requires consideration of the needs of the market for such services, the content of those services, the costs associated with the acquisition and delivery of that content and the revenue generated. It also necessitates consideration of the impact on existing FTA services.

3.7.1 Content

Internationally, multichannel DTT services tend to have certain characteristics, all or some of which could be expected to be replicated in Australia. In general, DTT multichannel services offer around 20-30 channels that include simulcast of the existing analog commercial and national broadcast services plus a combination of more targeted content offerings. Those offerings may include:

- Second channels provided by the five FTA broadcasters providing complementary content to their existing services using excess international content, archive programming, overspill sporting events;
- Time shifted broadcast of the primary channel;
- Dedicated news service(s);
- Children's channel;
- Niche lifestyle channels eg cooking, travel
- Community channels eg parliament
- Music video channel;
- Documentary programming;
- Archive programming eg classic Australian drama;
- Home shopping;
- International channels;
- Radio services

Multichannel DTT services internationally have not given rise to additional mainstream general entertainment channels that duplicate the primary services of existing terrestrial broadcasters. The relatively low number of boxes in most markets would not justify the expenditure on content of this nature. In addition, there is little incentive for existing broadcasters to erode their primary revenue base. Services therefore tend to be complementary to existing channels rather than directly competitive.

Much of the content on multichannel services could be expected to be acquired either through use of additional content from output deals or archive and time shifted material, or through carriage of third party channels. Foreign content is a mainstay of most multichannel offerings but has little impact on acquisition costs for primary services as it offers different genres of programming than those of interest to mass market channels. However, as a platform becomes more established, increasing amounts of original programming could be expected. This trend has been noted in the UK in relation to the Sky platform.[15]

OfCom has also noted the role of multichannel services in encouraging innovation and experimentation in local production:

> *"To support innovation, public service broadcasters are now also able to use digital channels to complement their analogue output. ITV2 and E4 have given viewers access to large-scale event TV. The BBC argues that BBC Three provides an alternative comedies such as Little Britain or Nighty Night with a testing ground, so that the most successful can transfer to BBC Two."*[16]

Similar trends have been seen with niche channels in the United States. "The Osbournes" for example started out as an experiment on MTV, became a cult success and then crossed over to mainstream network broadcasting. "Queer Eye for the Straight Guy" has enjoyed a similar path. These shows may never have been commissioned for prime time network schedules without a genesis in a multichannel environment. Their existence is a result of the opportunities afforded by the less pressured environment offered by niche channels.

Appendix 5 shows the range of channels currently available on DTT services in the UK, Germany and the United States.

3.7.2 Revenue

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.

However, Seven believes that there is room for advertiser supported free multichannels on the DTT platform as part of a free/pay service offering.

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[15] "However there are signs that UK programme investment is gradually increasing…" Ofcom review of public service broadcasting, Phase 1 Consultation Paper, page 41

[16] OfCom review of public service television broadcasting, Phase 1 consultation paper, April 2004, page 34

- *Advertisers support multichannelling*

Firstly, advertisers have indicated strong support for multichannelling in their submission to this Review stating that "the provision of advertiser supported terrestrial FTA multichannelling would allow advertisers to use the medium that most consumers would prefer"[17].

Currently, over 70% of the population cannot be reached by television advertisers in search of niche audiences. Pay TV penetration is currently at 23%. Even at projected penetration of 35-40%, this would still leave over 60% of homes that advertisers were unable to target through niche offerings.

Spending patterns on pay TV advertising serve to highlight increasing interest in niche advertising. In Australia, pay TV revenues have doubled in just two years, from $51m in 2001 to $102.5m in 2003. Pay TV advertising revenue grew 40% in 2003 and growth of at least 30% per year has been predicted for at least the next two years[18]. This indicates a healthy appetite from major advertisers to be able to target niche audiences to complement the mass reach of free-to-air stations, which remain the preferred outlet for advertisers.[19] Pay TV multichannel services are increasingly being sold as a medium to complement free-to-air advertising schedules.

Advertiser supported multichannels would allow advertisers to combine a mass and niche proposition on a single platform. This is an attractive sales proposition that would allow advertisers to purchase across multiple channels or to enable greater targeting of discrete audience segments.

This strategy has proved successful in other media sectors such as magazines and newspapers, where advertisers can buy space in a number of separate titles to accumulate a desired audience profile or can combine mainstream advertising in the general news section of a newspaper with a specific target group in a lift-out or insert. The increasing segmentation of newspaper content is testimony to the effectiveness of this approach which has delivered success to companies such as ACP and Fairfax in lifting advertising sales figures.

- *Multichannelling will attract some new advertisers to television*

Secondly, multichannelling can also be expected to attract some advertisers to television who have previously not been able to advertise on the medium due to cost or because they want a greater ability to target a particular audience sector rather than reach a mass audience. Dawn Airey, Managing Director, Sky Networks described this phenomenon in her speech to the ABA Conference in June 2004

> "*Big advertisers are increasingly drawn to niche channels that appeal to certain demographics. Ford has sponsored the main soccer output on Sky Sports for all 12 years of the Premier League's existence because it knows it is reaching those elusive 16-34-year-old males.*

[17] AANA Submission to DCITA Multichannelling Review, July 2004, page 42

[18] "MCN chief bullish on pay TV growth" Australian Financial Review, 12 July 2004, page 52

[19] Free to air television attracts 96% of television advertising and 35% of the total advertising pie - Source CEASA

> *The multichannel world is also attracting new advertisers to the medium who've never been able to use TV before because of the high cost of entry.*
>
> *I'll give you a simple example: golf.*
>
> *Ten years ago 100% of all advertising for golf brands used to go to print. Today they're spending several million pounds with Sky Sports. So not only is multichannel television attracting new advertisers, it's winning share from other media as well."*[20]

In Australia, pay TV has contributed to some growth in the television advertising market, estimated at around $25m per annum over the last 5 years. ABN Amro has calculated that over the past 10 years, metropolitan advertising spend has grown at an average rate of 5.4% each year. If pay TV is stripped from the data, the 10 year growth rate declines to 5.1%. This trend is more pronounced over the last 5 years where pay television has added a percentage point annually to the growth in advertising spend.[21]

Recent announcements by ITV in the UK also indicate a more optimistic outlook for multichannel advertising revenue. ITV has announced that it intends to triple the revenue it receives from its digital channels within three years. It has announced a target of £150m of multichannel revenues by 2007 compared with £50m generated last year from digital channels such as ITV2 and ITV News. ITV is also planning to launch a third digital channel later this year targeting older viewers.[22]

- *Free-to-air advertising revenue can withstand some change*

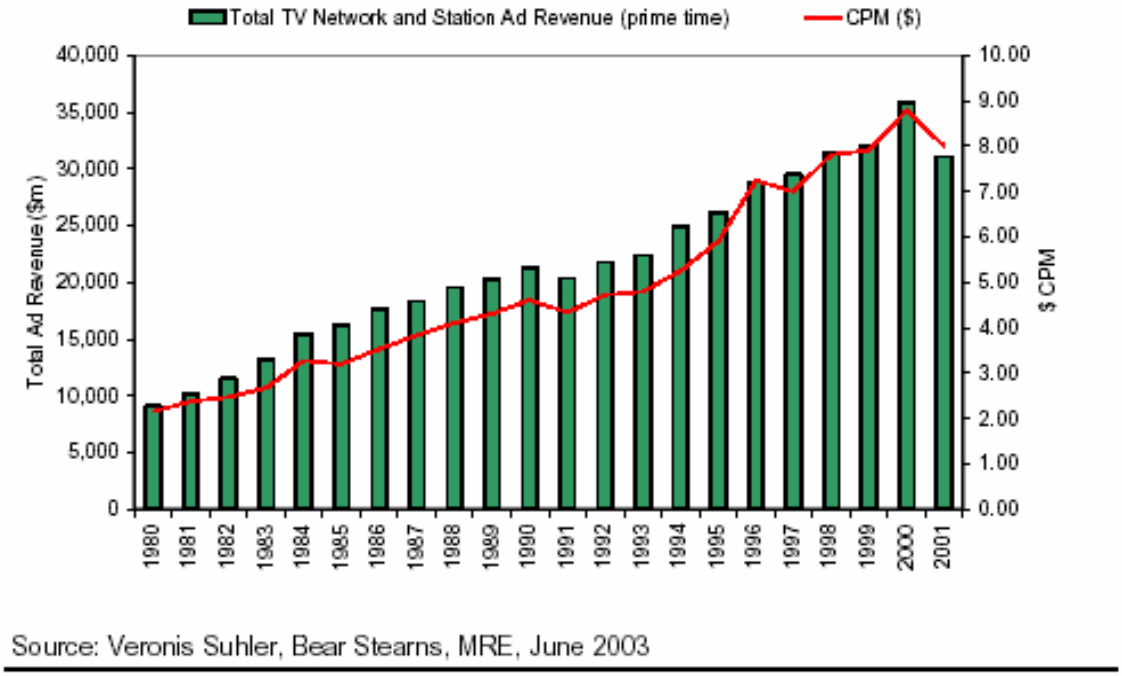
Thirdly, free-to-air advertising revenue is highly resistant to change and may even derive greater value from increased competition and fragmentation. The continuing growth in television advertising revenue and the premium payable to reach a mass audience on the primary services of free-to-air networks is well documented in the UK, the US and Australia. There is a high degree of correlation between these three countries in respect of both the share of advertising by main media and advertising growth, particularly between the United States and Australia. These established characteristics of the television advertising market are highly likely to be duplicated in Australia.

In the UK, the 5 main terrestrial channels' share of viewing has decreased. While still accounting for 76% of all viewing, this figure is down from 87% in 1998. However 85% of people in multichannel homes watch something on the five main channels every night. Despite this audience fall, free-to-air CPMs have grown at 5.2% CAGR between 1992-2002 and revenue has grown at 3.6% compound over the period.[23] UK commercial television revenue figures are also affected by by BBC licence fees, currently at around £2.3 billion per annum or 23.4% of television revenues.[24] The BBC's strong funding base places pressure on the commercial television sector that is not experienced in other major free-to-air markets. The relative historical weakness of the commercial free-

[20] "What I saw at the (Digital) Revolution", Address by Dawn Airey, Managing Director, Sky Networks, ABA Conference 24 June 2004
[21] ABN Amro ,"FTA Television – the TV margin cycle", 22 June 2004, page 31
[22] CSFB Global Media Team News 24 June 2004
[23] Macquarie Research Equities "Free to Air TV" 3 July 2003
[24] The Communications Market 2004, OfCom August 2004

to-air offering in the UK compared with that of Australia and the United States also tends to make the sector more vulnerable to shifts in the advertising market.

The story is even more pronounced in the United States, where free-to-air revenue has grown at 6% per annum since 1960, despite multichannel penetration growing to almost 90% in the same period and pay TV now accounting for almost half of prime time viewing.



Source: Veronis Suhler, Bear Stearns, MRE, June 2003

In Australia this trend has been mirrored in figures indicating a reduction in viewing of the free-to-air networks of around 10% due to pay television, but their share of total advertising revenue has remained relatively constant at around 35% while CPMs have grown faster than inflation at around 5.4% CAGR[25].

- *Diversified revenue streams are essential for DTT in Australia*

However, while Seven believes there is some room to accommodate advertiser funded multichannels, 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.[26] 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.

[25] "FTA Television – the TV margin cycle", ABN Amro, June 2004
[26] The Communications Market 2004, OfCom

However, the trend towards direct payment models is unmistakeable. In the UK, subscription revenues have grown total television revenues by over 11% in real terms since 1998, outstripping growth in other revenue sources.[27] 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.

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

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.*[28]

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.

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.

[27] OfCom consultation paper, page 27

[28] OfCom review of public service television broadcasting, Phase 1 Consultation Paper, p71

3.7.3 Impact on existing FTA broadcasters

Opponents of multichannelling generally cite three main arguments against its introduction:

- It will cause market fragmentation and consequently reduce network revenues;
- Content costs will rise significantly; and
- There will be a consequent reduction in the quality of the primary free-to-air services.

Multichannelling will have some impact on existing free-to-air broadcasters. It will contribute to the fragmentation of the market and have some effect on advertising revenues for the primary channel. However, it is unlikely that these impacts will be significant or contribute to a decline in the quality of existing services. Multichannelling may in fact be a vital element in any strategy to address some of the threats facing the industry.

Fragmentation is already occurring. Other digital technologiesare increasingly competing for viewers' attention. Pay TV, DVDs, the Internet and computer games are changing the way people use their time and their television sets consequently reducing free-to-air viewing. In coming years, technologies such as PVRs are likely to exacerbate this trend and challenge the traditional broadcasting model even further.

Faced with these trends, traditional free-to-air broadcasters need a strategy to answer the challenges they present. The ACCC considered this issue in its Emerging Market Structures report and concluded that "any benefits from maintaining the status quo may be lessened over time. The restriction on FTA multichannelling may actually prevent the FTA operators from responding to new sources of competition."[29]

Multichannelling offers the potential to retain viewers across a number of channels on the DTT platform as well as to target alternative revenue streams. A similar approach has been employed by newspapers in recent years through the increasing use of magazine style sections. As a result, newspaper publishers have seen their circulations stabilize and revenues retained in the face of increasing competition from the magazine sector, enabling them to continue to provide quality journalism and relevant content.

United Kingdom figures indicate that multichannel homes watch more television with viewing rising from 25.6 hours per week to 26.1 hours per week between 1999 and 2003. Viewing of multichannel services is beginning to overtake viewing of BBC1 and ITV1 for the first time.[30] A similar trend is evident in Australia, where pay television homes watch an average of 22 minutes more television per week and 50% of the viewing in subscription television households is of pay television services.

The impact on programming costs has been considered in greater detail earlier in this paper, with all indications that the impact on programming costs for primary services will remain largely unaffected. A recent OfCom report also indicates that the digital channels of terrestrial broadcasters do not have a significant impact on programming spend. Excluding the cost of movies and sport, the overall programming spend by the five UK

[29] ACCC Report on Emerging Market Structures, June 2003, p84

[30] "Terrestrial TV loses market dominance" MediaGuardian.co.uk, 11 May 2004

channels in the period 1998-2004 has increased by just 8% in real terms.[31] UK figures are also distorted by the 15% growth in the BBC licence fee and their consequent 27% increase in programming spend, which is not expected to be replicated in the Australian market. OfCom also found that even in the case of the BBC, while its digital multichannels now represent a majority of its programming hours, they account for only a "tiny minority" of its spending on television.

Seven agrees that the quality of existing services is of prime importance to consumers and must be protected in the interests of viewers and other stakeholders such as the production industry. However there is little evidence in Australia or internationally to suggest that a significant reduction in advertising revenue or rise in programming costs will eventuate if multichannelling is permitted.

In its report on Emerging Market Structures the ACCC reached a similar conclusion, saying:

> *"The Commission is skeptical of the need for the extent of the restrictions currently placed on multichannelling. No persuasive evidence has been presented to date to indicate that removing the prohibition on multichannelling would harm the FTA sector. The easing of the restrictions would provide FTA operators with the ability to offer new services to consumers and has the potential to provide a wider range of services to consumers."*[32]

The ACCC's comment draws attention to the interests of one group usually ignored by the opponents of multichannelling – viewers. The consumer research conducted by Seven on this issue indicates overwhelming support for new services on the terrestrial platform. Ignoring the demands of the public can only lead to long term problems for free-to-air broadcasters.

3.8 Program implications – availability of product and effect on existing services

These issues are largely dealt with earlier in this submission in the course of considering business models.

Seven is confident that additional product at low cost can be sourced through its output deals, archive programming and third party channel partners. Indeed a number of content partners have approached Seven unsolicited to express interest in providing content for multichannel services.

Cost of programming for primary services is expected to remain largely unaffected, as the content for niche and complementary services offered through DTT multichannelling is distinct from the content chosen for the mass market primary service. Consequently, the competition for content rights that has been speculated as leading to increases in content costs for primary channels would not eventuate.

[31] OfCom review of public service television broadcasting 2004, Phase 1, page 28
[32] ACCC Report on Emerging Market Structures, June 2003, page 85

Seven does not anticipate that in the initial years multichannelling would generate significant amounts of new local content. However there would be benefits to the production industry through the creation of secondary markets for programs (with attendant revenue streams from rights clearance). Over time it could be expected that a successful DTT platform would see increasing levels of first run locally produced programming.

Multichannelling also offers the potential to contribute to diversity in the broadcasting sector through the involvement of new content partners previously unable to participate on the platform.

3.9 Impact on subscription television

As with the free-to-air television networks, the impact of multichannelling on subscription broadcasters is expected to be minimal. The dynamics of the pay TV market in the face of DTT services is considered in some detail in section 8 of the Spectrum Report at **Appendix 2**.

As noted earlier in this section, recent figures released by Foxtel reveal it to be in glowing health and getting stronger. Digital subscriber conversion is well ahead of schedule and twice as many consumers are taking a full premium package than had been anticipated by the company. The proportion of customers taking the basic package is down to only 5% from 20% prior to digitization. This is in part a reflection of the cynical removal of key content, particularly movies, from the basic package. The company is on track to break even on its digital conversion in mid-2006, only 2 years after launching the new service.

Importantly, Foxtel is tracking the growth of BSkyB at the same period in BSkyB's history. However there are some important distinctions to be drawn that arguably deliver a more favourable operating environment to Foxtel than that in which BSkyB has built its service, widely considered to be the most successful pay television platform in the world.

If introduced, DTT multichannelling will be launching at a time when Foxtel is well clear of its launch phase and close to achieving full digital conversion. By contrast, DTT multichannelling was launched in the UK at the same time as BSkyB was undertaking its ambitious digital conversion process. At the time, digitization of a pay network on such a scale was very much unchartered waters and the investment was considered to have a high degree of risk attached. Foxtel's greater certainty of the benefits of digital and the fact that it is already well down the path to full digital conversion places it in a significantly better position than Sky to weather any minor impact DTT multichannelling may have on its operations.

Much is often made of the fact that Foxtel has not yet entered profitability. Significant losses are common to many pay television ventures internationally in the first 10 years and are often an indicator of the manner in which the controlling shareholders have elected to structure the business rather than a sign of commercial fragility. In Foxtel's case, the internal structuring of the business delivers significant returns to partners News and PBL while leaving losses to be shared with Telstra in the platform entity, BSkyB had only recently moved into profit when it elected to invest in its digital conversion. Having recovered its profitability in recent years, it has again elected to invest in long term

growth with its attendant tax and value benefits following market disappointment in its subscriber growth rate and its desire to remain a supergrowth stock.

As outlined in the Spectrum report, DTT multichannelling is not expected to compete head to head with subscription services on content or subscriber acquisition. The number of channels will be much smaller, due to technical constraints. The content offering will not contain premium product. The smaller audiences delivered by additional channels will not justify the necessary expenditure on premium content rights and there will be little incentive for broadcasters to compete directly with their existing primary services. In addition, many third party channels are available on a non-exclusive basis to both pay and DTT platforms. Many of these channels find a place on multiple platforms in other countries. As a result it is unlikely that there will be any movement of content away from pay to DTT platforms.

DTT multichannel services are increasingly viewed as a stepping stone to upgrading to full premium pay TV services and could therefore offer some benefits to existing pay operators. Foxtel's own projections are for pay TV penetration to plateau at 35-40%, leaving a significant proportion of the population to be targeted by low cost DTT multichannel solutions or be denied access to any multichannel platform.

There is a clear market gap between free-to-air and premium pay TV services that has been met in other countries through DTT multichannel offerings. These services are likely to prove most attractive to households that do not currently have pay TV but which would be attracted by a multichannel offering.[33] As noted by OfCom, "DTT is emerging as a very different environment from satellite or cable."[34]

3.10 Relationship between multichannelling, enhancements and HDTV

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 3**) 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 due to the amount of HD material currently shown to meet HD quota requirements. If this were to continue, multichannels would need to be scheduled around HDTV programming thereby reducing their consumer appeal.

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).

[33] "The Impact of allowing DTT multichannelling in Australia", Spectrum Strategy consultants, August 2004, p32

[34] OfCom review of public service broadcasting, Phase 1 Consultation Paper, p66

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.

If multichannelling is permitted the need for complex rules concerning program enhancements disappears. These provisions could be repealed from the legislation as all additional services ranging from enhancements to distinct additional channels would be permitted.

4 Subscription Services

4.1 Should FTA broadcasters be permitted to provide subscription broadcasting services?

The success of DTT multichannelling in Australia depends on being able to offer a mix of free and pay services. While suggestions that multichannelling will destroy the pay TV industry are exaggerated as discussed in Section 3 above, the smaller market size of Australia does suggest that there needs to be some modification to international models to accommodate this. In particular, the relatively constant share of advertising gained by television, the quantum of that share and the limited audience sizes that may be enjoyed by niche channels will limit the number of channels that are sustainable solely on advertising revenue.

Multiple revenue streams are fundamental to sustaining a sufficient range of viable new services that would be attractive to consumers. Free services are an important element in driving digital transition and a necessary "loss leader". Interestingly, pay only services had only limited success in the UK, Spain and Sweden and did not take off until a free component was added. As happened so successfully in the UK, Sweden has now added free services to a previously pay only DTT offering with immediate improvements in consumer take-up.

In Australia the pay landscape has been set for some time. Undertakings given to the ACCC in the Foxtel/Optus deal that were intended to facilitate third party access and new entrants to the pay television sector have proved to be commercially unattractive and have not given rise to any new participants in the sector.

In order for a niche channel with a low subscriber cost/value it must be included in the Foxtel "basic" package with access to revenues from the basic per subscriber fee. Foxtel has loaded the basic package with services that are either owned or partially owned by Foxtel partners. New entrants must therefore enter the market as a "tier" product requiring payment of high access fees by the content provider and a premium payment by subscribers. The premium/tier approach is not viable when subscribers must pay in excess of $50 for the basic package plus additional amounts for movies – premium channels owned and controlled by the Foxtel partners. Foxtel contends that it is endeavouring to reduce its costs and will not grant any further "basic" deals thereby precluding any new and viable market entrants on its platform.

As things currently stand, only one free-to-air broadcaster, the Nine Network, is permitted to have a subscription multichannelling involvement through its partnership with News Limited in Foxtel. Others such as Seven who have sought to diversify their business model and gain a position in the only available multichannel platform, pay TV, have been prevented from doing so by Foxtel and its partners. DTT multichannelling offers an opportunity to permit other free-to-airs to similarly develop strategies to address the threat to viewing share and revenue that is posed by pay TV and other new services.

The digital terrestrial platform offers the potential to restore competition in the only Australian communications sector that has none – pay TV. As noted in the Spectrum analysis at **Appendix 2** subscription DTT multichannelling is not necessarily a competitive threat to existing premium pay television services. DTT has the potential to

act as an "incubator" for premium pay tv services. This view is supported by Dawn Airey, Managing Director, Sky Networks who has stated

> *"the role of the platform in the British broadcasting ecology seems to be that of a nursery slope for those viewers who have never been exposed to real choice in broadcasting. Once they have it there is an expectation that at least a proportion will want to opt for a greater choice of channels and upgrade to the likes of Sky or cable."*[35]

It is vital also important that DTT subscription services should be permitted so that a full range of services can be offered on the platform and DTT is not perceived as a compromised or substantially more limited offering than cable and satellite. Otherwise there will be viewer resistance to acquiring the boxes and takeup will stall. The platform should be capable of delivering the widest possible range of services, including subscription services, so as to enable a complete response to viewer preferences.

Even more importantly, DTT offers the only remaining opportunity to introduce much needed competition to the pay TV sector. Failure to embrace this will entrench Foxtel as the defacto subscription monopoly in Australia.

4.2 Should FTA broadcasters be permitted to provide radio services?

The philosophy underpinning the use of DTT spectrum should be that there should be no limitations on the use of the spectrum providing that it delivers services specified within the broadcasting bands. Consumers should have the opportunity to receive the widest available range of services. It is noted that both the ABC and SBS are permitted to provide radio services using their spectrum, and that radio services are a feature of many DTT models internationally, particularly on the Freeview service and in Australia where Foxtel is providing 30 digital audio channels marketed as "Air".

4.3 Technical capacity for subscription services?

Subscription multichannelling services will require subscriber management, billing and conditional access services. Given the limited number of channels available to any one operator on the platform, it would not be viable for individual operators to each incur their own capital and operational costs associated with these vital support functions. It will be important to the success of DTT multichannelling that all services are required to operate on a common platform as a condition of licence covering all technical standards applicable to the delivery of services, including interactive capability.

Provided that all services are required to use common CA, encryption, EPG, customer management and technical parameters then there are no further technical requirements to create a common platform. The commercial arrangements to accommodate the various platform partners, including revenue and cost sharing would require detailed consideration but could be achieved.

[35] "What I Saw at the (Digital) Revolution", address by Dawn Airey, Managing Director, Sky Networks, ABA Conference, 24 June 2004, page 4

4.4 Ownership and control rules

The introduction of subscription services does raise issues relevant to ownership and control and competition considerations. In the UK, the dominant pay TV service provider BSkyB was not permitted to participate in the pay television offering of OnDigital due to competition concerns. Seven believes that this principle should extend to subscription services on the DTT platform in Australia. Existing pay television operators and their controlling partners should not be permitted to provide subscription multichannel services on the DTT platform.

As previously recommended by the Productivity Commission, foreign ownership limits should be lifted as a matter of urgency in order to stimulate maximum investment in the DTT sector.

4.5 Licence fee issues

The issue of licence fees raises complex considerations. Metropolitan broadcasters currently pay 9% of gross revenue in licence fees.

In its decision on the datacasting charge for commercial broadcasters, the Government addressed the question of how to remove the incentive to move revenue from a service with higher licence fees to a service with lower licence fees where the fees are a percentage of revenue. The Government decided that it was necessary to impose the same fee for all services on the platform to ensure gaming of this kind did not occur. It is likely that a consistent approach across all commercial free-to-air multichannel services will provide the most workable approach.

There will be costs in the introduction of multichannel services. A licence fee based on gross revenue may adversely impact the viability of new multichannel services until the platform establishes itself. This should be recognized through a moratorium on the licence fee for any free multichannels for a period of time.
There is some precedent for this approach in the United States, where the FCC granted a licence fee moratorium for 2 years on new multichannel services.

Subscription multichannelling raises different issues. Current pay TV providers do not pay any licence fees to the Government. To ensure competitive neutrality between similar services this should also apply to multichannel services on DTT. A percentage of any revenues generated will be garnered to the public purse via the taxation system. Much has been made in the past of the use of spectrum by commercial broadcasters. Yet despite licence fee payments of over $2 billion by the industry over the last 10 years, claims persist that the spectrum has been granted “free of charge”.

It is important to note that Foxtel has had the use of a significant public asset entirely without payment to the Australian public in the form of the Telstra cable. Not one cent has been paid by Foxtel or its partners to the Australian people in return for the exclusive use of this infrastructure. Nor have any licence fees been paid for any of the 150 channels on its multichannel service.

The Broadcasting Services Act 1992 points to price based allocation processes for the allocation of licences where an allocative mechanism is required because of scarcity. As in the United Kingdom, a specified price per channel along with an assessment of the

quality of the proposed service may deliver a higher likelihood of a diverse range of services than an auction process.

5 Content Rules

5.1 The operation of Australian content rules in a multichannel environment

Regulation of the new channels should be minimal, particularly in the establishment phases where business models are emerging. New multichannels (FTA and subscription) will be unable to sustain regulatory burdens until such time as the services have established themselves.

A similar approach was taken with pay TV services in the '90s. It is only relatively recently that pay TV has been subject to any level of mandatory Australian content rules. These apply only to drama channels and require a modest 10% of total programming expenditure to be spent on Australian content each year.

As noted elsewhere in this paper and in the Spectrum report, while they may not generate significant additional new content in the early years, multichannels will provide a valuable secondary market for Australian product that does not currently exist except in a limited form with pay TV. This should generate new revenue streams for producers and others involved in the production industry.

Over time given a successful model, greater amounts of new Australian programming could be expected on the platform. Once established and profitable, the sustainability of any regulatory requirements such as Australian content quotas could be considered. In this regard, Seven notes that the Australian Government has recently reserved the right in the Free Trade Agreement to impose Australian content requirements on DTT multichannels.

The imposition of Australian content requirements from the outset is likely to act as a disincentive to broadcasters commencing multichannel services by creating financial and operational obligations that would not be sustainable in a start-up business. A heavy regulatory burden would ensure the failure of the DTT model and all that it may be capable of delivering to viewers and the production industry over time.

Classification rules should be applied according to the nature of the service. In the case of subscription services, the more relaxed framework applicable to these services should apply. The smaller audiences likely to be delivered by free multichannels may also warrant some relaxation in the usual Code of practice requirements applied to mainstream network services.

It should be noted that content regulation of commercial broadcasting services is largely based on considerations of the ubiquity of the audience combined with the time of day of the broadcast. If the same content was broadcast at a different time, or to a more discrete group of the population, it is unlikely that the same classification rules would be required.

5.2 Anti-siphoning

All subscription channels, including those on the DTT platform, should be subject to the same rules as existing subscription channels. As with existing subscription channels, the rules should not prevent the joint purchase of free and pay rights by partners or vertically integrated operations.

Free multichannel services offer a considerable opportunity to make greater amounts of sport available to consumers free of charge without the scheduling difficulties currently experienced by single channel operators. Seven believes that the anti-siphoning rules should continue to operate to ensure that Australians are not forced to pay to view important sporting events. Listed events should be permitted to be shown on free digital terrestrial multichannels. The expanded channel capacity should however give rise to a "use it or lose it" rule to prevent hoarding of rights.

APPENDICES

Appendix 1 Crosby Textor Consumer Research

Appendix 2 "The Impact of Allowing DTT Multichannelling in Australia" Spectrum Strategy Consultants, August 2004

Appendix 3 Channels available within 7MHz allocation – current technology

Appendix 4 Channels available within 7MHz allocation – Windows Media9/MPEG4

Appendix 5 Channels on DTT services in UK, Germany and USA

DCITA Multichannelling Review

Seven Network Submission August 2004

Appendix 1

Multi-channelling
Qualitative & Quantitative Research
Report by Crosby Textor

CONFIDENTIAL

(This Report intentionally omitted)

DCITA Multichannelling Review

Seven Network Submission August 2004

Appendix 2

The impact of allowing DTT multichannelling in Australia
Report by Spectrum Strategy Consultants

The impact of allowing DTT multichannelling in Australia

Spectrum Strategy Consultants

August 2004

Contents

1 Executive summary

Seven Network has commissioned Spectrum to undertake an independent evaluation of the introduction of digital terrestrial television (DTT) multichannelling in Australia.

This document does not forecast the likely take up of DTT in Australia. Nor does it present a financial business case for DTT. The success of DTT in Australia in terms of penetration will depend upon the manner in which it is executed, including the number of channels, the range, mix and quality of services, price points (if subscription services are included), technology choices as well as any service's marketing and distribution.

Instead, the report focuses on the likely impact of DTT multichannelling on the affected stakeholders: viewers; FTA broadcasters; pay-TV operators; advertisers; the production community; and the Government. In doing so, it draws on evidence and experience from international markets.

This report represents Spectrum's professional view of how multichannelling would impact the market. By their nature, the forecasts contained here are based on the best judgement of our consultants. However, they are also based on a careful examination of developments across international markets and the current structure of the Australian broadcast industry.

Multichannel TV is here to stay

- Across all sophisticated markets, the future of television is one of mass market multichannel services delivered over multiple platforms
- This evolution is being driven by both developments in technology and evolving audience demand
- DTT multichannel services are now being launched in mature broadcast markets in a way that is complementary to other TV distribution platforms, such as digital cable and satellite
- Spectrum believes that if commercial free to air (FTA) broadcasters resist this market evolution in Australia, it will be contrary to the interests of consumers and be detrimental to the broader Australian broadcasting market.
- If Australia wishes to maintain its position as an advanced television market, with the on screen and off screen talent pools this implies, it needs to allow its broadcasting industry to develop and mature

Multichannel DTT has been or is being launched in most mature broadcast markets

- The total number of European DTT households is expected to reach nearly seven million by the end of 2004, growing to 23 million by the end of 2010
- Whilst the UK is by far the largest DTT market currently, other European markets such as Italy and France are expected to begin catching up in 2004 and 2005
- In the US, HDTV has had little impact and multichannelling is now appearing in the market
- Whilst the success of the medium is not yet assured in all markets, multichannel DTT is having a significant effect in many territories, rapidly increasing the penetration of both digital and multichannel households
- The major drivers of DTT success identified to date are content strategy (volume, mix, quality and distinctiveness); consumer entry costs (STB, smart card); service costs; DTT signal coverage and quality; and the role played by government

The impact of a successful multichannel DTT launch on Australian consumers will be positive

- Where take up has been high, such as the UK and increasingly Sweden and Italy, multichannel DTT has offered analogue TV viewers a far greater choice of services at little or no extra cost
- Despite the need to buy a set top box, many previously resistant or 'anti pay-TV' viewers have taken up DTT
- They have been attracted by the greater number, range and quality of services at a price that represents a compelling customer proposition
- The current Australian broadcast market structure does not offer this choice and therefore does not cater to the needs of all consumers
- DTT multichannel services will lower the cost of entry into the digital world for Australian consumers and lower the monthly ongoing cost of accessing multichannel television
- Hence multichannel DTT will offer more choice to the large number of price conscious TV householders
- Consumers that do not take DTT services will be no worse off than today, as we expect no quality reduction on the main terrestrial services

The impact on commercial FTA broadcasters will be neutral to positive

- It has been argued that multichannel DTT will adversely affect the commercial FTA channels by reducing their advertising revenues through audience fragmentation, drawing funds away from mainstream programming and through increased competition for programming
- Our assessment of the international experience suggests that these worries, whilst real, are misplaced and / or overstated
- Firstly, a DTT multichannel platform would have only a small impact on Australian FTA advertising revenues in the short to medium term. Audience fragmentation will occur in any case, due to pay-TV multichannelling, so DTT will only contribute to an existing trend. Internationally, mass-market FTAs have shown great skill at retaining advertising revenues despite some decline in viewing share
- The current 3-4% share of advertising revenues going to pay-TV operators suggests that Australian FTAs are no different in this regard
- Furthermore, rather than commercial multichannelling being a threat to FTAs' share of advertising revenues, Australian commercial broadcasters could use DTT to protect their share of the overall TV advertising market as the penetration of pay-TV grows
- Multichannel DTT will also attract new advertisers into the Australian market, as niche advertisers use multichannel television to reach more tightly targeted demographics. As such, rather than declining through fragmented audiences, the overall TV advertising market has the potential to increase its share of all advertising
- Secondly, the launch of multichannel DTT services should represent a choice for the broadcasters, rather than an obligation. They will only choose to 'divert' funds towards (and more likely invest new funds in) DTT services if they believe it will improve their overall commercial position. The FTA

broadcasters are entitled to different views on this point, and should be free to act differently, but this is not a reason to continue with prohibition

- Thirdly, the mix of DTT channels seen internationally, and expected in Australia, will not result in an increase in production costs through competition. Unlike a new commercial FTA channel, new DTT channels will not seek to mirror existing FTA schedules or even show much (or any) similar content
- The existing three Australian commercial broadcasters (and increasingly Foxtel) will remain the primary competitors for both premium acquired content and the rights to premium local and international events

The impact on the pay-TV sector will be neutral in the short to medium term

- The pay television sector is no longer a 'fledgling industry' in need of protection. With over 1.5 million households, it is now entering a phase of growing revenues and margins
- The immediate impact of a DTT multichannelling offering on a pay-TV sector is likely to be smaller the more established that sector is
- Therefore, in the short to medium term, it is unlikely that a DTT multichannel service will be a significant threat to the pay-TV sector. DTT services would most likely be targeted at analogue TV households that have decided not to take up 'premium' pay-TV, creating a three tier market of analogue, DTT and pay-TV households
- In fact, international experience suggests that pay-TV operators treat DTT as a useful 'stepping stone' to premium pay-TV, allowing viewers to experience multichannel television at an affordable price before deciding if they want to upgrade to a full premium TV environment
- In the longer term, as multichannel DTT becomes a mass market phenomenon, the degree of overlap between a DTT service and Foxtel / Austar will inevitably increase. At this point, the pay-TV networks will need to become more sophisticated, with respect to content selection, platform distribution and strategies adopted to attract and retain subscribers
- To use the example of the UK again, which is the most sophisticated DTT market in the world at present, BSkyB has announced plans to launch a free 112 channel offer via satellite, providing an alternative 'freeview' platform for households and demonstrating how this increasing competition and choice within a sophisticated Australian multichannel market will, in our view, be in Australian consumers' interests.

The impact on advertisers and the production community will be neutral to positive

- There are potential upsides and downsides for each of these stakeholders depending on the perspectives and strategies of various industry participants. Overall, we expect the impact on these stakeholders will be marginal
- International experience suggests that advertisers may have to pay a slight premium for concentrated mass market audiences as rates decline more slowly than audience levels for the main FTA channels, although the US shows that this is likely to happen regardless of the introduction of DTT
- However, they will also gain the ability to access to more targeted demographics through niche services. As with pay-multichannelling, DTT will also help to open up the TV advertising market to smaller, more focused advertisers

- In terms of production, the introduction of DTT multichannelling is unlikely to drive large numbers of new commissions since most material will already have been commissioned (international channels and repeats of existing material)
- However, some new opportunities should be created through additional live sports and events coverage, potential commissions from international channels looking to localise, the creation of a more vibrant secondary market and possible commissions from new 'second' services offered by the main FTAs
- Overall, the introduction of multichannel DTT should further contribute to the invigoration of the independent production sector fostered by multichannel TV in general

Multichannel DTT moves the Government forward against several stated objectives

- If it provides a compelling customer proposition, multichannel DTT will lead to an accelerated take-up of DTT services, shortening the path to analogue switch-off (ASO)
- It will also reduce the eventual cost of ASO as more households choose to switch to digital rather than having to be incentivised by the Government
- A strong DTT also has the potential to enhance economic activity in other industries in Australia, including set top box (STB) manufacture, interactive services and broadcast exports
- The uptake of digital, regardless of platform, will require the sale of STBs, receiving equipment and potentially integrated digital televisions (iDTVs)
- The development of interactive services such as home banking, home shopping and play-along functionality provides potential for increased economic activity in execution and development
- As markets globally become increasingly digital, the requirement to include enhanced/interactive elements in programmes for export will increase. Without the potential for such developments, Australia's production markets may become more marginalised

2 Study objectives and disclaimer

Spectrum has been commissioned by Seven Network to undertake an independent evaluation of the likely impact of DTT multichannelling in Australia.

The actual success of DTT in Australia in terms of take up, will depend upon the manner in which it is executed, including the number of channels, the range and mix of services, price points, technology choices and marketing and distribution. This document does not forecast the likely take up on DTT in Australia. It does not present a financial business case either.

Therefore, for the purposes of the current DoCITA review into multichannelling, this report focuses on the likely impact of DTT multichannelling on all stakeholders: viewers; FTA broadcasters; pay-TV operators; advertisers; the production community; and the Government. In doing so, it draws on evidence and experience from international markets.

DTT multichannelling in this context is defined as the provision of a mix of commercially focused niche channels over one or more available terrestrial multiplexes to a similar number of households as can be reached by simulcast DTT today. Reception will be through the use of a digital set top box, or a digital tuner (and potentially conditional access capability) embedded within the television itself.

Spectrum has exercised all reasonable endeavours in performing the work relating to this assignment. Any assumptions, projections, findings, conclusions and recommendations and any written material provided represent our best professional judgement based on the information available to us during the project.

As independent experts it should be appreciated that all analysis, opinions and conclusions reflected in this report are purely those of Spectrum and may not reflect the analysis, opinions and conclusions of Seven. Therefore the conclusions of this report do not necessarily reflect the official position of Seven and should not be seen as such.

3 Background to the review

3.1 The current review process

In May 2004, DoCITA issued a Paper entitled "Provision of services other than simulcasting by free-to-air broadcasters on digital spectrum." This Paper was issued as part of the Broadcasting Services Act 1992 (BSA) requirement for a series of 11 reviews of the broadcast market, to be conducted in 2004 and 2005.

The DoCITA Paper refers primarily to two matters for review

- whether the provisions requiring simulcasting of programs should be modified
- whether broadcasters should be permitted to provide additional types of services

3.2 Current legislation

The digital framework provisions of the Broadcasting Services Act limit the uses to which free-to-air (FTA) television broadcasters can use the spectrum allocated to them for digital transmission:

- commercial television broadcasting licensees are not permitted to broadcast television programs in digital standard definition television (SDTV) mode unless the program is broadcast simultaneously by the broadcaster concerned in analogue mode (Paragraph 7(1)(m) of Schedule 2 and clause 35 of Schedule 4 of the BSA)
- commercial television broadcasting licensees are not permitted to use their digital spectrum for provision of commercial radio, subscription broadcasting or subscription or open narrowcasting (paragraph 7(1)(p) to Schedule 2 and clause 36 of Schedule 4)
- commercial broadcasters must transmit a quota of high definition (HDTV) programming, which must also be a simulcast of their SDTV / analogue service and may also provide enhancements that are closely and directly linked to the primary service

3.3 Initial rationale for prohibiting FTA multichannelling

When the digital framework was constructed in 1998, the Government excluded multichannelling for commercial free-to-air broadcasters in order to protect what was then described as "the fledgling subscription television industry."

It was also considered that consumer demand for new and different services would be met through 'datacasting' and that datacasting would therefore drive take-up of consumer equipment. However datacasting services have not evolved significantly during this time period. Few potential datacasters have come forward. The restrictions on datacasting make it commercially unattractive and the services launched to date have held little consumer appeal. Australia is the only market to have taken this type of approach and others are unlikely to follow its lead. Even where such restrictions do not exist internationally, datacasting services have not emerged as a stand alone business model.

3.4 2000 Productivity Commission Broadcasting report

The Productivity Commission report on the broadcasting industry in 2000 stated that digital broadcasting will create opportunities for new players and new services in the market. The report recommended several actions including

- providing for early digital conversion and release of spectrum when available

- relaxing restrictions on digital services (datacasting and multichannelling) and picture formats. High definition transmission should not be mandated

The report concluded that, “without substantial [legislative] changes, the digital conversion plan is at serious risk of failure.”

The report highlighted the social and cultural objectives of broadcasting policy, such as ensuring diversity and plurality of sources of information and opinion, adequate levels of Australian content and appropriate program standards. The report stated that “diversity of sources of information and opinion is most likely to be served by diversity in ownership of media companies, and by competition.”

3.5 2003 ACCC report on the communications sector

In June 2003 the Australian Competition and Consumer Commission (ACCC) produced a report entitled Emerging Market Structures in the Communications Sector.

The ACCC made some recommendations in relation to competition in the broadcasting sector including that the Government conduct an ‘across-the-board’ review of the regulations applying to the media sector, with a focus on regulations that affect competition, including digital multichannelling, datacasting and anti-siphoning.

The ACCC found that relaxing the prohibition on digital multichannelling by FTA operators “could heighten competition both between the existing FTA operators and between the FTA and pay-TV sectors” by creating scope for “innovation and a wider variety of service offerings.”

The ACCC concluded that no persuasive evidence had been presented that removing the prohibition on multichannelling would harm the FTA sector. It found that allowing FTA operators to multichannel would create an opportunity for each FTA operator to develop new business models and capture revenue streams not available in a single channel environment.

In the light of this evidence, the ACCC considered that broadcasters should have a choice about whether to multichannel based on their own cost-benefit-analysis and commercial strategies.

4 Overview of broadcast market developments

4.1 Evolution of TV distribution

The evolution of TV distribution within sophisticated broadcast markets can be summarised by four main trends:

- Transition from a free TV environment to a mixed free / pay-TV environment
- Transition from a single / dual distribution platform to multiple distribution platforms
- Transition from limited channel line-ups to multiple channel line-ups
- Transition from pure 'linear' TV to a mix that includes 'on-demand' and interactive services

Exhibit 1: Evolution of TV distribution

	Old-world	New world
Model	Free	Free / Pay mix
Distribution	Single /dual analogue platform	Multiple digital platforms
Channels	<10	50-200+
Format	Linear	Interactivity & on-demand

Source: Spectrum Strategy Consultants

4.1.1 TV revenue model

Traditionally, broadcasters have had two primary revenue sources: advertising and, for State broadcasters, licence fees or government funding. Programme sales supplement the traditional revenue model to a small degree.

The introduction of pay-TV licences internationally, predominantly in the late '80s and early '90s, introduced a new revenue model to the television broadcast market. Pay-TV has had varying levels of success in markets internationally, with driving factors depending on several market characteristics including, but not limited to, affordability, the existing FTA environment, network reach and regulatory environments. The US and Germany illustrate the diversity in pay-TV success levels. Whilst the US has a pay-TV penetration rate of nearly 90%, pay-TV penetration in Germany has struggled to grow. The UK is regularly cited as one of the worlds leading pay-TV markets with penetration of nearly 50% of households, served by three pay-TV operators (two regional cable operators and one national satellite operator).

4.1.2 Distribution platforms

Traditionally, broadcast services have been transmitted generally through a mix of terrestrial and cable platforms, depending on the infrastructure in each market. In the UK, the BBC and the commercial broadcasters transmitted entirely on terrestrial whilst in Germany, due to extensive network infrastructure and the tendency to live in high-density housing blocks, cable was the dominant distribution platform.

Through the evolution of technology, and the introduction of new TV broadcasters, primarily through the pay-TV model, new distribution platforms have been rolled out resulting in the emergence of a multi-platform environment.

TV broadcast platforms now include terrestrial, cable, satellite and DSL. Internationally, FTA markets predominantly use terrestrial, whilst pay-TV markets have been most successful over cable or satellite. TV over DSL is still in its infancy but it is emerging in some markets, such as Hong Kong where PCCW has launched a pay-TV service over its fixed telephony network.

The second major transition in distribution platforms is from analogue to digital. Whilst most major TV markets are still predominantly analogue, all are moving increasingly towards digital. Cable and satellite networks have generally been quick to upgrade their networks and migrate customers to digital, often through heavily subsidised set-top-box sales. Terrestrial networks have spent heavily on digital upgrades and are in the process of migrating customers to DTT. For terrestrial broadcasters, there are various further complications to customer migration.

Firstly, unlike in the pay-TV world, customers have not previously required any new equipment since the introduction of colour. To receive DTT customers need a STB or a TV with an in-built digital tuner. As such, even in the FTA world, DTT requires customers to spend money.

Secondly, the structure of the FTA market, with various commercial and national broadcasters, is such that a coordinated strategy and investment approach to DTT is required. In the terrestrial environment, viewers expect a single STB or iDTV to be able to receive services from all the commercial and national broadcasters, requiring common technological standards across broadcasters. Due to a diverse range of views, budgets and funding models, agreement amongst FTAs and national broadcasters on the most appropriate path to DTT is often difficult to find.

As such, for DTT, government intervention to some degree is a market characteristic, especially as governments have set timelines for switching off the analogue terrestrial broadcast frequencies – generally referred to as Analogue Switch Off (ASO).

4.1.3 Multichannel

Multichannel TV penetration has been increasing in almost all developed-world markets globally, including Australia. The driver of multichannel penetration has traditionally been cable or satellite, but now terrestrial broadcasters are playing a greater role in the development of the multichannel environment.

Pay-TV operators launched with multichannel services long before digitisation of the networks. Pay-TV operators have primarily built services around a cable or satellite distribution platform, which both have far greater capacity than the analogue terrestrial frequencies allocated to television broadcasting.

The development of digital broadcast and compression technologies has led to a huge increase in the capacity of broadcasting networks across all distribution channels. This increase in capacity has led to a corresponding increase in the number of channels carried by networks. As a result, the digital customer proposition has even greater appeal and so digital has led to sustained growth in multichannel take-up. Again, the pay-TV networks have been the primary beneficiaries of increased multichannel take-up, as they have generally been the first to embrace digital technologies through network upgrades.

Terrestrial networks are capacity constrained on analogue due to frequency limitations. In order for terrestrial networks to offer a multichannel proposition, terrestrial networks need to be upgraded to digital.

4.1.4 'On-demand' and interactive services

There has been a transition from pure 'linear' TV, where content is simply broadcast to viewers, to an interactive environment where viewers have far greater empowerment. Interactive services change the viewing experience from programme selection to the format in which a programme is viewed, enabling consumers to 'personalise' the service that is broadcast to them.

On-demand services enable consumers to watch what they want, when they want. Rather than paying a monthly subscription fee, consumers can choose to pay a one-off fee for a specific 'event'. In the case of non-live content, such as movies, consumers can also choose when they watch (though current on-demand services are primarily still scheduled services with several viewing windows, facilitated by multichannel TV).

Typically, on-demand services are offered as incremental to a pay-TV programming package, rather than as a standalone service (though this may change over time. In the UK, BSkyB is offering a non-subscription multichannel service, dubbed 'Freesat', with the aim of enticing customers to make on-demand transactions for premium content).

The range of on-demand content genres is increasing. Initially big ticket sporting events were offered on-demand, such as heavyweight boxing, movies then followed and now operators are moving toward more diversified on-demand content.

'In programme' interactive services have also been developed whereby a consumer can personalise the format of content being viewed. One of the pioneers of this was Sky Sports in the UK which offers a 'player-cam' interactive service during its broadcasts of live Premier League football matches. Player-cam enables a viewer to watch an individual player during a match rather than watch the match as broadcast in standard format. Interactivity is being built into a growing number of successful TV formats, in different ways, such as voting through the TV, and 'click-through' information and shopping services.

Interactive services over DTT have also been launched, though not to the same extent. Freeview offers a number of interactive content channels such as BBCi and yooplay. The BBC offers news, weather, video clips and entertainment listings on its BBCi service. BBC coverage of the Open Golf and the 2004 Olympics all have extensive interactive sports coverage using BBCi. Viewers can access the latest results, video highlights, player profiles or sports news, and, at certain times, viewers can also choose live alternative coverage to the main broadcast, allowing viewers to follow more than one game at a time.

4.2 TV formats and viewer behaviour

Viewer behaviour has undergone significant changes as viewers have access to an ever-greater variety of content. Viewers' desire for greater choice is reflected in the take-up of pay-TV and, more recently, in the take-up of free multichannel services, such as Freeview in the UK. As greater demands are made on viewing schedules by the increase in choice, broadcasters will need to be more flexible in their scheduling.

There has been a significant increase in the range and diversity of TV formats. This has fuelled viewers' appetites for innovative formats, creating a more dynamic market. Recent years have witnessed a marked shift in viewing preferences and the emergence of a new trend of "reality TV" or "docudrama" formats and interactive game shows.

In addition to changes in TV viewer behaviour, TV audience figures are also being impacted through increased competition for viewer time from other formats, such as DVD and Internet (especially amongst

young people). In Australia, TV prime time viewing penetration has fallen from 35% in 1995 to 30% in 2004. About 50% of this decline can be attributed to DVD and Internet consumption.[1]

4.3 Societal benefits of digital TV

Digital allows greater capacity and therefore creates the ability to offer new channels along with new services such as interactivity and event-based pay-TV. As such, digital allows broadcasters to cater for the growing variety of audience needs.

Multichannelling also allows broadcasters to explore and trial new concepts in order to continue to produce innovative and compelling content in a market that must cater for increasingly demanding audiences.

Through digital, consumers have access to more information and a greater variety of entertainment services. Minority groups and community services can be better catered for in a multichannel environment leading to an increase in the welfare of the population as a whole. As such, digital TV benefits the whole of society.

[1] Deutsche Bank, 2004

5 Review of DTT multichannel deployment internationally

5.1 DTT in the UK

The UK is the most developed market worldwide for digital terrestrial television. Currently, four million UK households receive the DTT signal[2], equating to about 17% penetration (this compares with 4% DTT penetration in Australia)[3]. DTT was launched as a pay-TV service in 1998 under the brand On-Digital, which later became ITV Digital. ITV Digital struggled to compete with rival pay-TV operators for a number of reasons and eventually went into bankruptcy in 2002.

There are many reasons for the failure of ITV Digital, as outlined in the exhibit below.

Exhibit 2: Why ITV Digital failed

- ITV Digital had poor management
- ITV Digital launched with very high costs in every area of the business and then overpaid for the lower division football rights
- ITV Digital was dependent on BSkyB's premium sports and movie content to drive up customer numbers but made very little money from this package
- ITV Digital attempted to compete head on with BSkyB particularly in the area of sports rights but without sufficient content or price differentiation.
- BSkyB employed damaging tactics in content pricing and set top box subsidies that cost ITV Digital several hundred million pounds
- Technical and transmission issues that affected the viewing experience and limited reach. In some areas the poor picture quality contributed to high churn levels and created negative press
- Late entry into a mature and highly competitive pay-TV market. BSkyB had taken ten years to build up a highly integrated pay-TV platform based on "must have" Premier League football matches and exclusive Hollywood film deals. ITV Digital found it difficult to compete head on in this mature pay TV market, where most potential subscribers were already owned by BSkyB
- ITV Digital's subscription service offering was not sufficiently compelling. Channels such as Granada Plus or Granada Men and Motors failed to capture audience share

Source: Spectrum Strategy Consultants

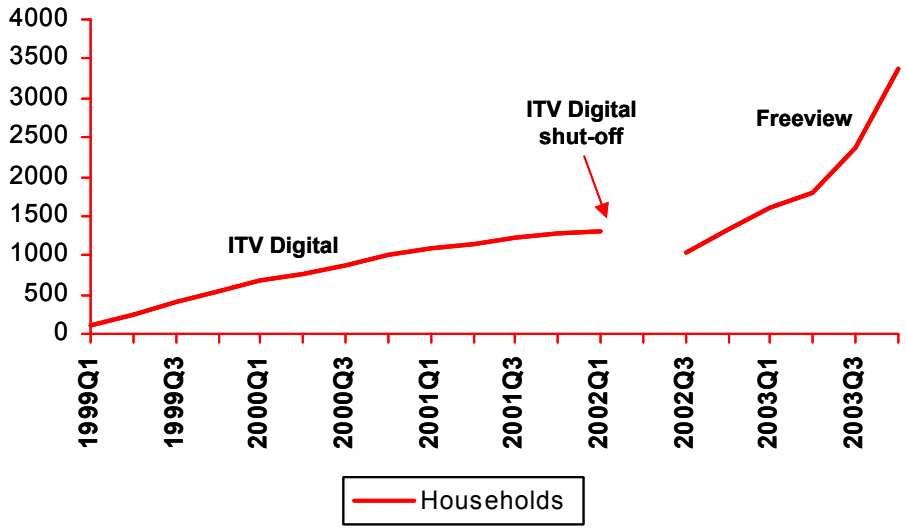
One of the key reasons why ITV Digital failed is its attempt to compete in an already crowded and developed pay-TV sector. As such, when the UK Government re-licensed the digital terrestrial spectrum to a consortium of the BBC, BSkyB and Crown Castle, it was interested in the free DTT model. Freeview, a free multichannel service, was launched by the consortium later in 2002.

Freeview has witnessed explosive growth in its first 18 months, especially when compared to ITV Digital. Freeview's customer base rose by 2.4m in its first 18 months compared to ITV Digital which managed only 1.3m customers in over three years[4]. Recently, 'Top-up-TV' has been launched. This mini-pay service is in addition to the Freeview offering. Top-up-TV reported that 20,000 subscribers signed up for the service in its first month but it is too early to assess its commercial success.

Later in this chapter, we review the drivers of success of DTT, drawing on the Freeview and ITV Digital experiences in the UK.

[2] Ofcom, July 2004
[3] AsiaCom, 2004
[4] Informa Media, 2004; Spectrum Strategy Consultants

Exhibit 3: DTT households in the UK (000s)

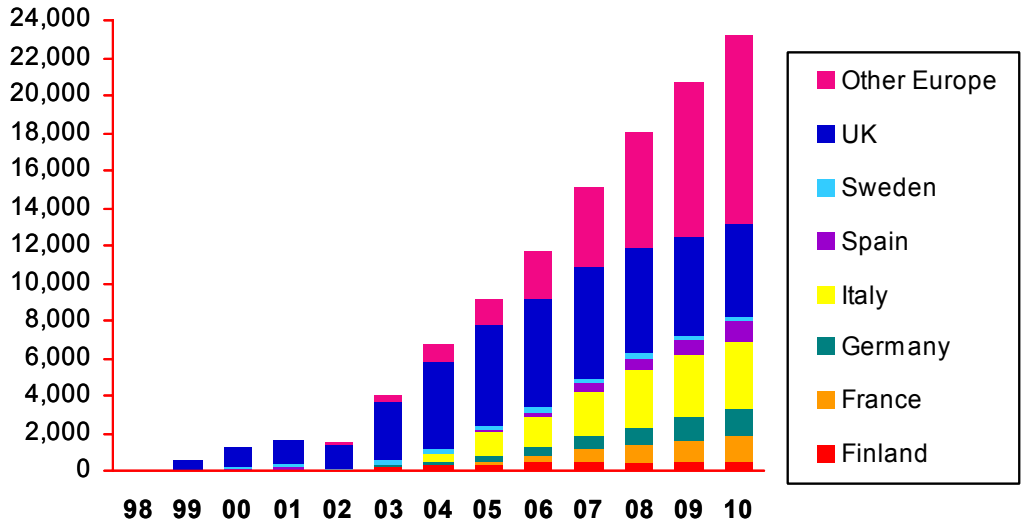


Source: Informa Media 2004

5.2 DTT in Europe

DTT has been around in Europe since 1998, with Sweden the first to launch. DTT has now launched in several countries in Europe and most countries which haven't yet launched plan to do so in the near future.

Exhibit 4: European DTT customers (000s) and penetration of households (%)



Source: Informa Media 2004

The total number of European DTT households is expected to reach nearly seven million by the end of 2004, growing to 23 million by the end of 2010. Whilst the UK is by far the largest DTT market currently, other countries such as Italy and France are expected to begin catching up in 2004 and 2005. Mediaset, the Italian DTT operator, claims to have around 500,000 DTT STBs in households and states that it is adding 3,000 DTT households a day[5]. At this rate, Mediaset could have as many as one million DTT customers by the end of 2004. In Sweden, there are forecast to be 250,000 DTT households by the end of 2004.

Exhibit 5: The Progress of European DTT

	Launched	Nature	Notes
Austria	Planned		• Yet to launch
Belgium	No		
Denmark	No		
Finland	Yes	Free	
France	Planned	Mix	• Yet to launch
Germany	Yes	Free	• No conditional access
Greece	No		
Ireland	No		
Italy	Yes	Mix	
Netherlands	Yes	Pay	
Norway	Planned		• Yet to launch
Portugal	Planned		• Yet to launch
Spain	Yes*	na	• Quiero bankrupt 2002 - no new model yet
Sweden	Yes	Mix	• Initially pay, moving to mixed
Switzerland	Planned		• Yet to launch
UK	yes	Mix	• Pay, then free, moving towards mixed

Source: EBU; Euromedia

Various DTT business models have been tried with broadcasters choosing between free-to-air services, pay services and a mixture of both.

As yet, no clear 'best practice' model has emerged. DTT markets are still nascent and it is not yet possible to tell how the landscape will develop in the long term. Success or failure in each market is, to a great extent, down to the specific characteristics and competition in each market and the strategy of each DTT business.

However, importantly, in every territory in which DTT has been launched or planned, multichannel services are an accepted integral part of the consumer offering.

[5] Company Data

5.3 Drivers of success

The major drivers of DTT success can be considered around six key elements:

- Content strategy (volume, mix, quality and distinctiveness)
- Consumer entry costs (STB, Smart card)
- Service costs
- DTT signal coverage and quality
- Role of government

5.3.1 Content strategy (volume, mix, quality and distinctiveness)

Multichannelling is about offering customers greater choice of content in terms of volume and diversity. The content offering is the key driver of consumer take-up of multichannel services, before cost or platform. Without a compelling range and diversity of content, viewers will not be attracted to DTT and DTT will not be able to reach the critical mass it requires to compete in the broadcast market.

Emerging DTT propositions in Europe currently offer, on average, 25 or more channels, including the mainstream commercial and national channels as well as a number of more niche channels. These niche channels are very different from mainstream mass market entertainment channels, targeting specific demographics and social groups, such as ethnic minorities or children. Channel line-ups typically include a broad mix of genres and time-shifted, mainstream programming. A typical DTT free-to-air channel proposition would include:

- the digital broadcasts of the existing FTA analogue services including PSB channels
- new '2nd channels' of mainstream FTA broadcasters, showing complementary and extended / time-shifted programming
- multiple dedicated news channels
- children's channels
- niche channels e.g. travel, cooking
- community service channels e.g. Parliament
- international channels

No additional mainstream mass market entertainment channels are currently found on free DTT platforms in Europe. Additionally, free DTT platforms are generally not competing in the premium content market, such as iconic sports and movies, leaving this content to mainstream FTAs and pay-TV operators. There are three main reasons for this. Firstly, DTT multichannel programming budgets are not sufficient to be able to compete with established players for rights or high-cost in-house production. Secondly, DTT does not yet have enough reach to achieve a return on high budget programming, either from advertising or subscription.

Exhibit 6: A broad mix of mainstream and niche genres comprise the channel line up of DTT

UK **Germany**

Source: Company websites

Thirdly, the typical strategy of DTT operators is not to compete head-to-head with established players, but to offer a complementary service, and target under-served customer segments, such as those who cannot afford pay-TV.

This strategy is illustrated by the channel line-up on Freeview and Top-up-TV in the UK. Freeview's offering consists of:

- the five mainstream FTA channels (BBC1, BBC2, ITV, C4 and C5);
- the second channels of the mainstream broadcasters (BBC3, BBC4, ITV2);
- four news channels (BBC News 24, ITV News, Sky News, Sky Sports News);
- children's channels (Cbeebies, CBBC);
- community service channels (Community Channel, BBC Parliament);
- niche channels (Sky Travel, UK Bright Ideas, UK History, the hits, TMF); and
- shopping (QVC, Ideal World, bid.up.tv, price-drop).

Top-up-TV offers:

- childrens' channels (Boomerang, Cartoon Network);
- niche channels (UKTV style, Home and Leisure, Bloomberg, UKTV Food, Discovery, Turner Classic Movies); and
- entertainment (E4, UKTV Gold).

In the entire Freeview and Top-up-TV channel line-up there are no dedicated sports channels, no premium movie channels and no mainstream entertainment channels. The closest to mainstream entertainment that the offering gets is E4, which is a subsidiary of PSB Channel 4, offering content targeted primarily at young adults and older children. E4's audience viewing data reveals a very narrow demographic compared to the mainstream channels.

There are exceptions to this DTT content strategy. Mediaset in Italy has recently acquired the live DTT broadcast rights to three Serie A (Italy's highest soccer league) clubs, placing it in direct competition with the country's only pay-TV operator, Sky. Mediaset claims that it has no wish to enter a subscriber war with Sky,

but feels that it needs premium sports to drive take-up of the DTT platform. Mediaset will offer Serie A soccer as a pay option, though it is believed that only 50% of Italian DTT STB's are suitable for pay services[6].

As cited above in the ITV Digital case study, one of the reasons for ITV Digital's failure was its attempt to compete directly with Sky. ITV Digital bought rights to non-Premier League soccer believing that viewers would still have a strong interest in the lower leagues of the sport. ITV Digital overpaid significantly for the rights and also priced the service too closely to Sky's sports package. The majority of potential customers found Sky's content more appealing and this hindered take-up of ITV Digital, whilst leaving them with a large financial commitment. In short, the company paid too much for lower quality sports rights which they attempted to sell to customers at an unrealistic price similar to the premium package offered by BSkyB.

Whilst DTT platforms in Europe are aiming for quality programming, they are, in general, not aiming to compete directly with existing broadcasters. Generally, the DTT offering is targeted at households whose requirements are not (sufficiently) met by existing FTA or pay services.

The analogue terrestrial FTA market may not be able to meet consumer requirements because

- terrestrial analogue has limited capacity to carry channels and therefore limited broadcast hours in which to meet all of the content needs of the viewing public
- commercial broadcasters are dependent on advertising revenues meaning that they need to capture as large an audience as possible and, as such, programming needs to have a mass market appeal which can therefore not sufficiently cater for niche audiences

Pay-TV may not cater to all sections of the population due to

- pay-TV coverage being less than 100%, meaning certain households cannot access pay-TV services
- a (relatively) high pay-TV entry price, meaning lower income households, or households which place 'lesser proportional value' on TV, do not have access to pay-TV services

It follows therefore, that DTT success depends, to a large extent, on its ability to find or create an appropriate niche in the market for its content offering.

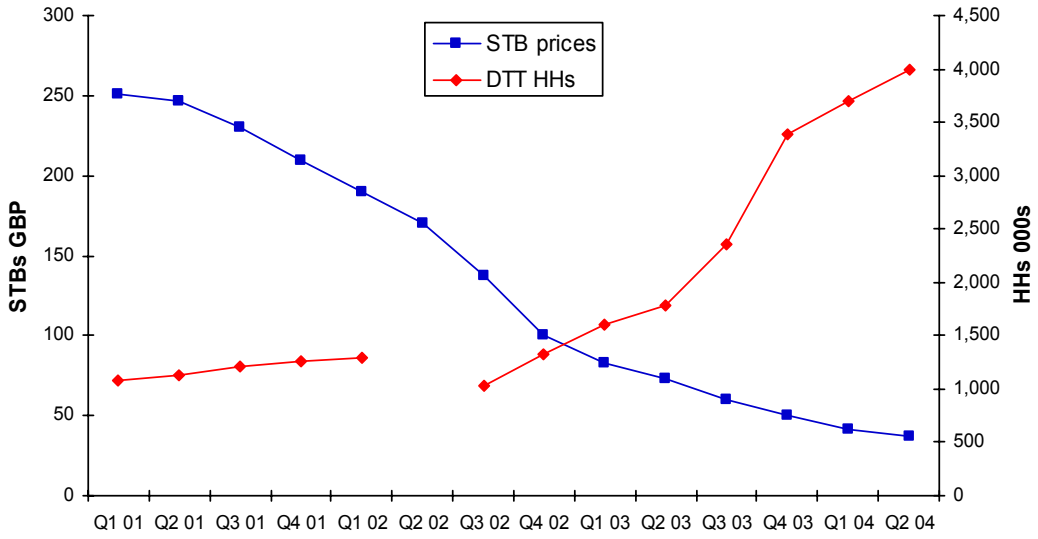
5.3.2 Consumer entry costs

In any consumer market, the cost of entering the market is a key element in determining the level of product adoption. In DTT, a STB or a television with an integrated digital tuner is required to receive the DTT signal.

In the consumer electronics industry a 'virtuous spiral' exists whereby, as a product becomes mass market, prices fall, enabling greater affordability. As such, the decline in prices is faster in markets where consumer uptake is rapid, leading in turn to faster uptake. The effect of this can be seen in the UK where high street electronics retailers have been offering heavy discounts on STBs.

[6] Macquarie Securities, 2004

Exhibit 7: DTT take-up, millions of households, versus STB prices in the UK



Source: ITC / Ofcom; press coverage

Additionally, for free-to-air DTT, many STBs do not require the same complexity as pay-TV STBs, such as conditional access technology, helping to reduce manufacturing costs.

As a result, the cost of STBs has been falling over time and is now considerably less than the cost of STBs in Australia. In the UK for instance, an entry-level STB for the Freeview service costs around A$100 in high street retail outlets[7].

Exhibit 8: Dixons offers 3 STBs for less than £40 in the UK: Matsui, Grundig and Techwood

Source: dixons.co.uk

In Australia the cost of a STB has already fallen from around A$700 to A$250[8]. However, experience from the UK and other markets would suggest that, if DTT can be a mass market proposition in Australia, prices can fall by another 60%. Dixons, the UK high street retailer, dropped its STB prices dramatically in the belief that the free Freeview multichannel proposition coupled with low-cost STBs would encourage mass market take-up.

[7] Retailer websites; market research; Spectrum Strategy Consultants
[8] Market research; company data; Spectrum Strategy Consultants

Increased sales volumes helps retailers to create economies of scale and therefore offer lower prices to consumers.

In a short period of time, the number of STBs on the market has increased enormously, with a vast array of quality and capability available.

Exhibit 9: Average cost of an entry-level STB in Europe

	2001	2003
Brands	1	29
Models	1	34
Average cost	249 Euros	99 Euros

Source: EBU

5.3.3 Service costs

Another key determinant of DTT uptake is whether the service is free, pay or a mixture of the two.

Most pay-TV operators require customers to agree to a contractual obligation from the moment of purchase (e.g. it is common practice in the pay-TV environment to require consumers to agree a minimum contract length for monthly subscriptions on signing up for the service).

Markets have taken different approaches, with some having changed strategies as a result of unsuccessful campaigns. The UK is a good example here, with DTT initially launched as a pay service and then, after the failure of ITV Digital, re-launched as a free service. In a further development, now FTA services on the Freeview platform are being supplemented by a pay-TV service, called Top-Up-TV, which offers an entry-level 'mini-pay' offering of ten channels. Top-Up-TV carries a range of popular channels, also available through the main pay-TV operators, but for a cheaper package price. Top-Up-TV is available to households with a DTT STB for £7.99 per month (c. A$19) compared to Sky's entry level package of £13.50 and typical packages of £30+[9]. Additionally, there is no minimum subscription period for Top-Up-TV (the minimum subscription period on Sky is 12 months), though there is a £20 connection fee. Exhibit 3 (above) showed the increase in the take-up rate of the free DTT service in the UK, compared to the relatively slow take-up rate of ITV Digital's pay DTT service.

[9] Company data

Exhibit 10: DTT service offerings by country (2004)

	Free channels	Pay channels	Notes
France	19	15	• Yet to launch
Germany	26	0	• No conditional access
Sweden	9	21	• Initially a pay TV model moving increasingly to mixed
UK	26	10	• Initially a free model, moving towards mixed

Source: Spectrum Strategy Consultants – subject to ongoing change

The European experience, whilst still nascent in many markets, suggests that the key to rapid growth of the DTT platform is the provision of free services. If the basic service is free, in that there are no ongoing costs, consumers are encouraged by the 'single payment' for the set-top-box without a commitment to further expenditure.

The European experience seems to show that it is difficult for a 'pure-pay' DTT model to compete with cable and satellite pay propositions, as cable and satellite generally have a significant head-start in pay-TV markets and greater capacity to carry new channels.

The experience in the UK of the growth in Freeview households compared to the previous growth in ITV Digital households illustrates this. Additionally, analysts believe that DTT in Sweden was priced too closely to cable and satellite pay-TV packages and that this hindered take-up. Swedish DTT has now moved towards a mixed offering of free and pay channels.

However, whilst consumer adoption of free DTT is clearly faster than pay DTT, the business model is not yet proven. There are concerns around the free and mixed (free / pay) DTT business models. There is scepticism that the pure advertising-funded multichannel model will have the ability to generate enough revenues to support a multichannel proposition. The mixed models in France and Sweden have been accused of not having enough of either pay or free content to attract subscribers or advertisers, respectively.

5.3.4 Coverage and signal quality

Coverage and signal quality are important factors in establishing DTT services. Obviously, in order to maximise take-up, coverage must meet the highest proportion of households possible. It should be noted however, that only 73% of UK households are covered by the DTT signal and DTT penetration is 17%[10], whereas in Australia, DTT coverage is around 90% and penetration is just 4%[11]. It can therefore be concluded that, whilst important, fully national DTT coverage is not the key driver of DTT take-up.

Signal quality is also important as poor signal quality damages the DTT brand and leads to increased churn. The lessons from poor quality DTT signals are highlighted in the demise of ITV Digital which suffered from a weak signal and broken reception in households subscribing to DTT services. When Freeview took over the DTT platform in the UK it employed a different strategy, sacrificing channel capacity for signal strength.

[10] Ofcom; BBC
[11] DoCITA; company data; Spectrum Strategy Consultants

5.3.5 *Role of Government*

The role of governments in DTT development is critical. International experience suggests that they need to set flexible frameworks, allowing broadcasters to offer DTT services that fit with their own market's broadcast environment. Their role will also be important in the final stages of analogue switch off (ASO).

At the beginning of the DTT migration process governments need to intervene to create the right environment for DTT broadcasters. Governments have considered taking several steps, including, setting ASO timelines, mandating digital tuners in TVs, sponsoring advertising and awareness campaigns, and labelling TV sets to state which will continue to function beyond ASO.

Exhibit 11: Table showing role of government in DTT

	Direct consumer subsidy	Broadcaster compensation	Government / PSB driven	Notes
France			✓	Yet to launch
Germany	✓	✓	✓	Berlin only
Sweden	X	X	X	PSB strongly involved
UK	✓	X	✓	STB subsidies likely for poor

Source: Spectrum Strategy Consultants

Towards the end of the DTT migration process it is likely that government intervention will also be required to migrate remaining analogue households to digital and to switch-off analogue signals. Once digital reaches a certain penetration level, it will be more cost effective to subsidise the migration to digital of those remaining on analogue than to run analogue and digital services simultaneously. The Berlin regional government took this approach and is the first territory to achieve analogue switch-off as a result. The UK government has indicated that it will also subsidise STBs under certain conditions.

However, if governments set out the correct framework at the start of the migration process, it is less likely that further intervention will be required until the ASO point is reached. Governments, for the most part, should be able to leave DTT migration to free market forces - broadcasters, viewers and equipment manufacturers.

If a DTT platform is ultimately to replace the analogue service in a country, then the public service broadcasters must also be involved. This is reflected in the 'must carry' rules in place for some DTT platforms. More generally, public service broadcasters have played an important role in the development of DTT. DTT in France and Germany was pushed heavily by their respective Governments and, in the UK, the BBC has been instrumental in funding Freeview, using the proceeds from the licence fee to fund new digital services. In countries where DTT is showing signs of success, the DTT offering typically includes services from a combination of national broadcasters and private companies.

6 Impact of DTT multichannelling on viewers

Any changes to broadcast regulation must be carefully weighed and considered. Television plays an important role in many Australian households, providing entertainment, information and a shared medium that helps to bind the nation together.

Any analysis of the impact of changes to the broadcast environment should begin with a review of the likely impact on the audience. Viewers are the broadcasting industry's primary customers. They demonstrate their satisfaction by watching services, delivering ratings which commercial broadcasters can sell to advertisers to generate revenue.

In assessing the impact of the introduction of DTT multichannelling, we have examined

- the likely impact of multichannelling on the overall range and diversity of content available on TV
- the likely impact on the quality of services available
- the likely impact on the reach of services and on digital take up

6.1 Range and diversity of programming and formats

The launch and growth of new broadcast services will continue to significantly increase total programming output. The launch of ten or more channels over DTT would result in hundreds of hours more programming available to Australian viewers. Internationally, multichannel offerings have vastly increased the volume of entertainment, documentary, music, drama and children's programming available to the public. Viewers have supported this increased choice by shifting some (but by no means all) of their viewing away from traditional FTA channels and towards new services. Viewers in multichannel homes also tend to spend more time watching television.

Additionally, a multichannel environment provides greater capacity for commissioning and airing experimental programming. Second channels and niche channels can provide opportunities for content producers to be more innovative. A recent Ofcom review highlighted this trend, stating:

"To support innovation [free-to-air] broadcasters are now also able to use digital channels to complement their digital output. ITV2 and E4 have given viewers access to extended coverage of large scale event TV. The BBC argues that BBC Three provides alternative comedies such as Little Britain or Nighty Night with a testing ground, so that the most successful can transfer to BBC Two."[12]

Innovative programming helps to identify new growth segments and enriches the market overall. Without multichannelling broadcasters are restricted in the amount of experimental programming aired due to the need to maximise advertising revenues. This process is already underway, thanks to the launch of pay-TV and Foxtel's recent digitisation. As with many of these trends, DTT multichannelling could accelerate developments.

Digital technology also allows broadcasters to offer on-demand services enabling consumers to watch what they want, when they want through the payment of a one-off fee for a specific 'event'. This empowers consumers to make choices about their individual TV consumption. Ultimately, on-demand leads to more choice for consumers.

[12] Ofcom Review of Public Service television broadcasting 2004, page 34

Digital technology also facilitates 'in programme' interactive services which allow consumers to personalise the format of content being viewed and to access information and services not available through a linear TV service.

Finally, it appears that consumers are more interested in a range of diverse services than having improved picture quality (such as that offered by High Definition TV) across only existing services. For HDTV to be effective, customers must replace their existing TV sets with expensive HDTV sets. Whilst we expect the penetration of high definition TVs to increase gradually over time, especially as the price differential falls, there is little evidence that HDTV drives the take of digital in the same way that service diversity (i.e. new channels) does. There are currently only 400,000 DTT STBs in Australia[13], suggesting that HDTV is not a driver of strong consumer demand. Going forward, HDTV may have a vital role to play across certain channels or genres, but Spectrum, believes viewers will derive more benefits from DTT multichannelling than they currently derive from HDTV.

6.2 Programming quality

6.2.1 Multichannel programming

It is often suggested that the quality of output on new channels is, on average, lower than that of mainstream programming. Quality is of course subjective, and many viewers of niche channels would disagree. It is true that niche channels typically spend less per hour on programming than mainstream channels. It is also true that niche channels have quite different programming strategies from the mainstream channels.

However, the fact that new niche channels do not broadcast the same range of high quality programming as mainstream channels is neither a surprise, nor a major issue. If viewers have access to incremental new content which they want to watch, this should be seen as an additional benefit. Although working with smaller budgets, niche channels often broadcast flagship programming that compares well with mainstream programming in that niche.

If the quality of a DTT multichannel offering is not sufficient, consumers will not watch. Such a scenario represents a neutral impact on viewers rather than a negative impact as they will be in no worse situation than currently.

6.2.2 Mainstream programming

A greater perceived risk is that the quality of mainstream services might in some way be impaired as a result of reduced funding for programming, due to fragmentation of advertising revenues, or higher programming costs.

Again, Spectrum believes that the risk here is limited, at least in the short to medium term. Whilst multichannel households spend less time watching primary services, there is strong evidence to show that mainstream TV still dominates viewing in multichannel households and that multichannel homes watch more television overall. In Chapter 7, we develop this argument further to show that the impact of new niche channels on mainstream advertising revenues is unlikely to be significant in the short to medium term.

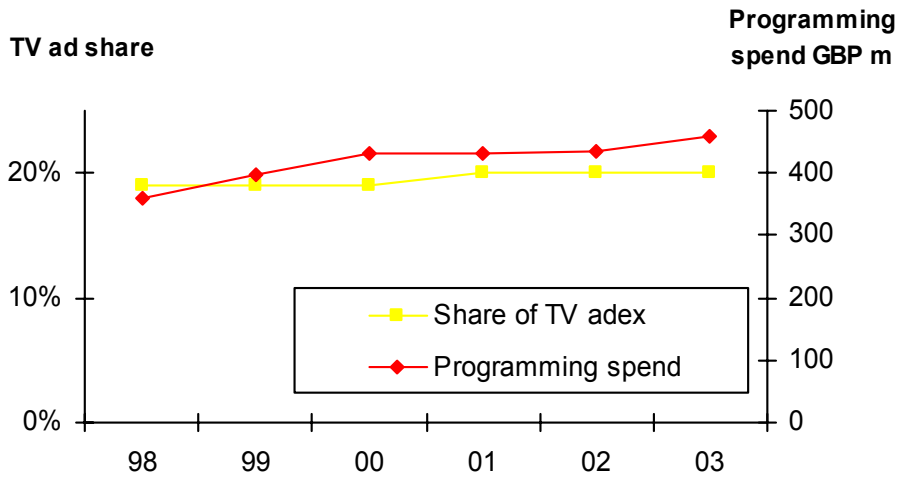
Given that mainstreams broadcasters should not lose much revenue to niche channels, programming investment need not be significantly impacted by them. It is difficult to judge how different mainstream

[13] DoCITA; company data; Spectrum Strategy Consultants

broadcasters will manage their programming expenditure in a multichannel environment but there is currently little or no evidence to suggest that programming quality has fallen in multichannel markets internationally.

Evidence from Channel 4 in the UK shows how the broadcaster has maintained its share of TV advertising revenues whilst increasing programming spend during a time of increasing multichannel penetration. Channel 4 is renowned for its experimental programming and innovative programme formats and has maintained the quality of its output during this period. However, excluding the cost of sport and movies, program expenditure by the five terrestrial channels in the UK has increased by only 8% in real terms in the period 1998-2004.[14]

Exhibit 12: Programming spend compared to share of TV advertising revenues: Channel 4



Source: Company data; Informa Media

International case studies suggest that as multichannel penetration increases and the overall broadcast market becomes more competitive, mainstream broadcasters themselves become more competitive. That is, they work even harder to make programming that will rate well and therefore (by definition) is commercially successful.

In some markets, commercial and public broadcasters have been accused of moving to 'lowest common denominator' programming or 'dumbing down'. There is a genuine debate to be had as to how far governments should intervene in broadcast markets in order to ensure that certain types of programming are produced (such as Arts and Education, or locally produced content). This public service broadcasting (PSB) debate is raging in several countries, but it is quite distinct from the impact of DTT being considered here.

Spectrum believes that it is far more appropriate for Government to achieve its PSB objectives through licence conditions (such as local production quotas) and its approach to funding rather than through the prohibition of

[14] Ofcom review of public service television broadcasting, 2004, page 28

new services. This is certainly the trend internationally, with governments increasingly identifying and explicitly separating the economic and PSB components of broadcast regulation.

Ultimately, competition forces broadcasters to compete harder for viewers, and therefore advertising revenues, which should lead to improvements in quality and efficiency. If quality is poor, viewers will not watch programmes, and so commercial broadcasters and multichannel broadcasters will be forced to maintain quality standards in order to maintain commercial performance.

6.3 Reach

6.3.1 Reach of content

Multichannelling enables mainstream broadcasters to re-run content at different times on second channels, meaning that consumers have more freedom to consume content when it suits them as individuals. A multichannel environment reduces the need for viewers to make a specific "appointment to view" and therefore reduces barriers to information consumption in modern, hectic, life. As such, a multichannel environment increases the reach and therefore appeal of broadcast content.

6.3.2 Reach of multichannel services

Whilst Australia is already a multichannel environment, the number of multichannel households is limited by the cost of the service. Penetration levels suggest that whilst the current pay-TV multichannel offering provides a depth and breadth of services, its price / service mix is not compelling for many Australians. The current basic pay-TV package costs around A$49 (depending on the platform) per month with a further A$200-300 (on average) upfront installation costs and a minimum contract length of six months. The full channel line up from Foxtel costs A$94.95 per month[15].

DTT multichannel services could lower the cost of entry into the digital world for Australian consumers and offer a service package with low, or no, ongoing costs. As such, DTT multichannelling can help to bridge the 'digital gap' and prevent Australia from becoming a two-tier society comprising those with multichannel services (and therefore greater choice and information) and those without.

6.3.3 Digital penetration and analogue switch-off

Experience from international markets suggests that DTT multichannelling is likely to be the most effective driver of DTT penetration in Australia and therefore may be the most effective way to quicken the journey to analogue switch-off (ASO) in Australia. If the Government wishes to achieve ASO, it needs consumers to want to buy a STB and for STBs to be affordable. One way of encouraging consumers to purchase STBs is to enable broadcasters to provide a compelling DTT customer proposition, which can be best achieved through a free multichannel offering.

The need for FTA to have a role in digital take-up was acknowledged by Greg Dyke, former Director-General of the BBC, in a speech to the EBU in 2001. Dyke stated that, if digital was purely synonymous with pay-TV, digital penetration would likely flatten out at around 55%-65% in the long term, preventing analogue switch-off from being possible.

If multichannelling is introduced in Australia it will accelerate the 'virtuous circle' effect discussed in Chapter 4. As more consumers demand multichannel services, the cost of a STB in Australia will continue to fall, which in

[15] Company data

turn will make multichannel services more affordable and more attractive to the mass market. We have already seen STBs in Australia fall in price but research of European electronics retailers suggests that there is room for Australian STB prices to fall much further (see Chapter 5). DTT STBs in Australia currently cost around A$250 compared to around A$100 in the UK[16].

6.3.4 Further considerations

It should also be noted that, in order for DTT to successfully meet the needs of Australian consumers and the Government's aim of ASO, broadcasters will need to work together:

- to expand the DTT signal to have eventually the same household penetration as the analogue signal (although coverage has already reached 90%); and
- to develop common technological standards across commercial and national broadcasters so that consumers can access DTT services from all commercial and national broadcasters through a single STB or IDTV.

[16] Company data; market research; Spectrum Strategy Consultants

7 Impact of DTT multichannelling on FTA broadcasters

7.1 Market evolution

Much of the debate around DTT multichannelling concerns its likely impact on the existing free to air (FTA) broadcasters. It is clearly wrong to suggest that there will be no impact, since a successful multichannel launch will, by definition, take some viewing share from the existing players. However, Spectrum believes that the overall revenue impact is likely to be small and that there are significant positive non-revenue impacts.

Spectrum believes that the future of television for all sophisticated, mature markets is a multi-platform multichannel environment. In Chapter 4, we set out why we believe that this is inevitable. As discussed, the growth of multichannel markets is being driven by two main factors:

- technology evolution: digitisation and improved compression technology are enabling more services to be offered using existing spectrum resource; and
- viewer demand: viewers are responding positively to increased choice. Programme makers are responding creatively and innovatively to the increased 'display space' for their programmes.

An increasing number of developed countries are allowing DTT multichannelling and are taking steps to promote its success. Australia is the only developed country to have implemented DTT that has prohibited multichannel services. If Australia wishes to maintain its position as an advanced television market, with the on screen and off screen talent pools this implies, it needs to ensure that its industry is allowed to develop and mature.

However, it is easy to see why free to air broadcasters would look to defend the status quo. Any new service can be seen as a threat that might attract viewers and hence revenue. However, Spectrum argues that to continue to prohibit DTT multichannelling at this stage would be detrimental to the market. This includes the FTAs themselves in the long term. The best path for the industry is to try to embrace a multichannel environment rather than trying to maintain the current market structure.

The rest of this chapter examines the likely impact of DTT multichannelling on FTA advertising revenues and TV production costs in Australia.

7.2 Advertising revenues

7.2.1 Potential erosion of advertising share

It is reasonable for FTAs to fear that multichannelling will lead to an erosion of commercial FTAs' TV advertising share as these channels' share of viewing is diluted. This is based on the assumption that TV advertising revenues will remain stable, but in future will have to be shared across a greater number of channels.

The concern is valid. However, it is easy to overstate both the monetary impact to an FTA of losing viewer share and the impact of any decline in advertising share. Furthermore Spectrum believes that an attempt to avoid this advertising share erosion through 'not reacting' would be misguided and not in the long term interests of FTA broadcasters. Television viewing is already fragmenting and traditional broadcasters need a

strategy to address this. In the UK in March and April the multichannel share of viewing exceeded the viewing of BBC1 and ITV1 for the first time[17].

It is an undisputable fact that the primary channels of the FTAs will attract a lower share of viewing in multichannel homes than in analogue terrestrial homes. Evidence suggests that multichannel household viewers choose to watch a variety of services. However, despite this decline, the FTAs primary services remain pre-eminent and typically continue to be the only real mass-market services. Even in the UK, which has a very strong pay-TV multichannel sector at 43% penetration[18], the five mainstream channels still retain 76% of viewing[19]. In the US, with 88% pay-TV penetration, the major networks still retain a 45% market share of TV viewing, and a 71% share of TV advertising revenues[20].

The fact that the main channels retain their unique mass-market status, means that whilst declines in FTA advertising as a result of multichannel penetration have occurred they have not been as significant as originally anticipated. FTAs are able to increase the premium that they place on their advertising, even as competition erodes their viewing share. Significant falls are typically seen only with the introduction of a new mass market service (such as Channel 5 in the UK which took 5% of the UK TV advertising market within a year of launch). In recent years, this share has been further boosted to 8%[21].

In Australia, whilst pay-TV penetration is 23%, pay-TV's share of viewing is only 10% and its share of TV advertising expenditure is only 3-4%[22]. Seven, Nine and Ten still retain over 95% of the TV advertising market in Australia. Australian FTAs have been successful in retaining advertising market share, despite the existence of a (pay-TV) multichannel environment. .

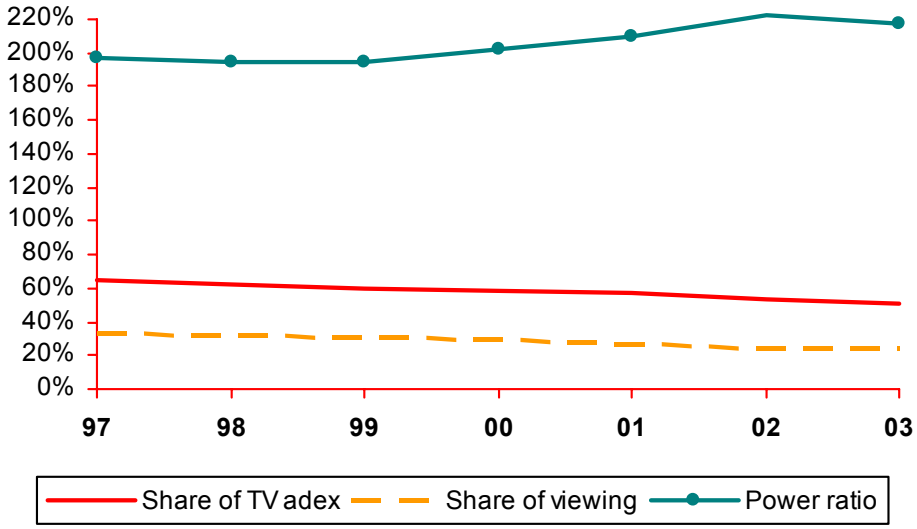
Pay-TV's audience is now split amongst 130 channels with no single channel exceeding 1% audience share[23]. As such, commercial channels secure audiences anywhere between 25 and 250 times the size of individual pay-TV channels.

Based on UK DTT viewing patterns, FTA multichannels could be expected to attract similar audience size and revenue share as pay tv channels. In the light of this, we see no reason why a DTT multichannel platform would have an extreme impact on Australian FTA advertising revenues in the short to medium term.

This view is supported by experience in leading multichannel markets, where there is evidence to show that mainstream FTA channels' share of advertising revenues have fallen more slowly than their audience shares. Audience fragmentation in multichannel environments means that few channels can deliver a mass audience, even if this mass audience is smaller than in the past.

[17] "Terrestrial TV loses ratings dominance" The Guardian, 11 May 2004, reported that in April the combined multichannel share was 26.1% compared with 24.3% for BBC1 and 22.8% for ITV1 following a similar trend for March.
[18] Merrill Lynch, Aug 2004
[19] Barb
[20] CSFB 2004
[21] Zenith Media 2003
[22] Deutsche Bank 2004
[23] Deutsche Bank 2004

Exhibit 13: Case study: UK TV advertising market (ITV share of viewing / ad revenues)



Source: Informa Media 2004

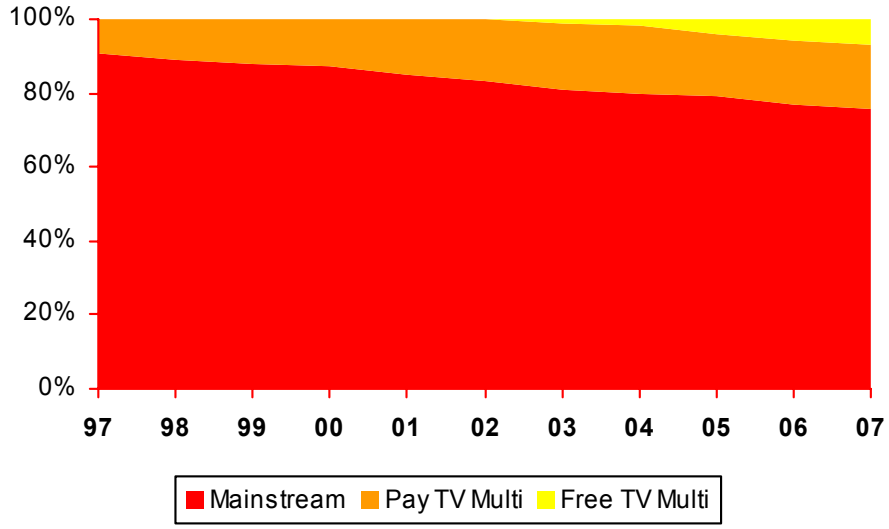
Mainstream channels can therefore charge a premium for advertising slots (higher cost per thousand than in the past) and thereby stem the erosion of advertising revenues. Analysts and media buyers show evidence of this by plotting the 'power ratio' (defined as, share of advertising revenues divided by viewing share), as shown in the exhibit above. Evidence from Europe and the US, where FTAs have high shares of advertising spend despite high pay-TV penetration, show that the power ratio has increased, indicating that the fall in advertising revenues is less dramatic than the fall in viewing share. In the UK, as pay-TV penetration has grown to 43%, ITV's power ratio has increased from 197% in 1997 to 217% in 2003[24].

In the long-term, however, evidence from other markets suggests that pay-TV's share of advertising will increase and that the impact on FTAs can be significant. Once multichannel households and hence viewership of non-mainstream channels reaches a critical mass, their share of advertising can increase quite significantly. In the US, for example, 29% of TV advertising spend goes to Pay-TV, though pay-TV penetration is 88%[25]. In the UK, multichannel TV now takes about 19% of TV advertising revenues[26]. This tipping point will come regardless of whether DTT multichannelling is allowed, although DTT could bring the date forward.

It should be noted that even in these very sophisticated markets, although a significant portion of revenues has moved across to the multichannel operators, the vast majority of advertising revenues remain with FTA broadcasters. Annual growth in the advertising market has also minimised the impact of multichannelling on revenue share.

[24] CSFB 2004; Spectrum Strategy Consultants
[25] CSFB 2004
[26] Zenith Media; Informa Media; CSFB; Spectrum Strategy Consultants

Exhibit 14: Split of TV advertising revenues in the UK



Source: Informa media; Spectrum analysis

In this environment, rather than DTT multichannelling being a threat to FTAs' share of advertising revenues, Australian commercial broadcasters might use DTT to protect their share of the overall TV advertising market through multichannelling. It is inevitable that some advertising revenues will move to multichannel TV. However, the migration of revenues need not be to pay-TV operator or third party channels, it could be to niche channels operated by commercial broadcasters.

7.2.2 New sources of advertising revenue

Spectrum expects the introduction of DTT multichannelling to further the trend for new TV advertisers to enter or expand their presence in the Australian market, as smaller or niche advertisers are able to exploit multichannel television as an advertising medium.

Mass market television has never been an easy medium for more focused, niche advertisers. However, multichannel television allows broadcasters to attract smaller, more tightly targeted audience demographics, with much lower levels of waste. This further offsets any revenue impact of multichannelling by generating new TV advertising dollars whilst mainstream advertising dollars stay with the mainstream channels.

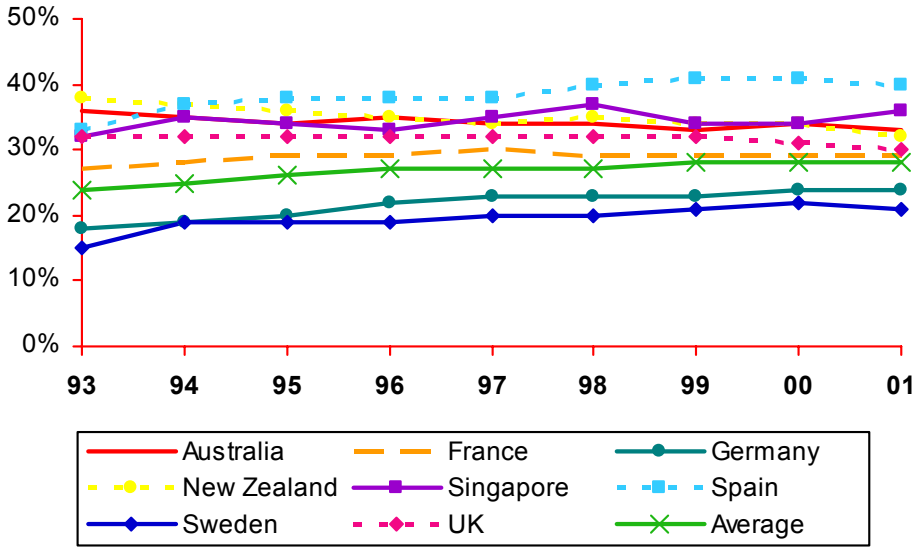
Evidence of this can be found in international pay-TV markets where new TV advertisers and categories of TV commercials have emerged. Whilst mainstream TV still remains the primary home of big budget advertisers such as auto manufacturers, cosmetics brands, fmcg (fast moving consumer goods) brands and supermarkets, new advertisers have targeted channels which reflect their products. As Dawn Airey, Managing Director of SKY Networks, pointed out in her recent address to the ABA Conference in June 2004:

"The multichannel world is also attracting new advertisers to the medium who've never been able to use TV before because of the high cost of entry. I'll give you a simple example: golf. Ten years ago 100% of all advertising for golf brands used to go to print. Today they're spending several million pounds with Sky Sports. So not only is multichannel television attracting new advertisers, it's winning share from other media as well."

Examples of this can be seen in other categories such as travel, where travel agents and cruise lines advertise on travel and adventure channels, or in business services, where companies as diverse as airlines providing business class flights and IT companies selling CRM solutions buy space on channels such as CNBC. Local advertisers, such as restaurants and bars are also advertising on regional feeds and metropolitan channels.

As such, rather than declining through fragmented audiences, the TV advertising market has the potential to experience growth. In the UK, TV's share of total advertising spend has increased at the expense of print media, and in absolute terms TV advertising revenues have increased strongly. Although, it should be noted that in many markets, other more fundamental structural changes in the media market can hide this effect.

Exhibit 15: TV ad spend as a % of overall advertising expenditure (international comparison)



Source: Informa Media 2004

The launch of multichannel DTT is fundamentally different from the launch of a fourth, mainstream commercial broadcaster, which would divert significant advertising revenues away from the existing broadcasters. A new mainstream broadcaster would be in direct competition to Seven, Nine and Ten, targeting mass audiences and the same advertising revenues. A new channel would have an entirely different cost structure and therefore need to compete immediately for a mass market audience. As stated above, when Channel 5 launched as the UK's fifth mainstream terrestrial channel, it attained 5% of the TV advertising market within its first year[27].

In summary, in Australia we expect the share of advertising attracted by pay-TV to grow quite rapidly over the next 12-24 months, as multichannel household penetration continues to increase and as more and more advertisers include pay channels on their buying roster. The introduction of DTT multichannelling would marginally hasten this growth. However, we expect the financial impact on the FTAs to be relatively small, as

[27] Press coverage; AsiaCom

the overall advertising market grows and as the main channels use fragmentation to extract higher mass market premiums from advertisers, despite falling audience shares.

7.3 Programming costs

Another concern often raised is that DTT multichannelling will lead to a significant increase in programming costs. Spectrum does not agree that this is a risk, including in Australia.

Internationally, the multichannel proposition has not proved to be a high programming cost model, especially when considered relative to the cost of running a mainstream commercial channel. The reason for this is in the nature of the programming that is carried on a multichannel service:

- much of the programming will be provided through carriage of third party channels. Hence the programming has already been commissioned and paid for;
- much of the programming will be niche programming, and hence represents new (cheaper) commissions or available at low cost through acquisition; and
- original programming will often be in the form of 'additions' to existing mainstream channel programming (e.g. time-shifted programming and re-runs).

Although foreign content is a mainstay of most multichannel offerings, there is unlikely to be an increase in acquisition costs. This is because most multichannel programming would be unlikely to be a target for mainstream mass market channels. The commercial FTAs compete for largely different product. The same is true of live sports of events rights. The existing players will continue to compete alone for the largest events due to their ability to deliver mass audiences to sporting bodies and their sponsors. New channels are likely to bid for events and sports that currently do not receive much exposure or that are supplementary to current analogue FTA offering (e.g. extended coverage or simultaneous programming). Another reason that programming costs will remain under control is that there will be no new bidders for premium movies. International evidence suggests that no new DTT channels are likely to be movie only services.

In short, the existing Australian FTAs are unlikely to compete much, if at all, with any new DTT channels for acquired content, live rights, or local commissions resulting in little or no impact on program rights costs. It is worth noting, however, that a DTT multichannel distribution platform would allow FTAs to get more value out of sports rights and would therefore allow them to compete on a more even basis with pay-TV bidders.

8 Impact of DTT multichannelling on pay-TV operators

8.1 The pay-TV market

As set out in Chapter 3, the initial 1998 decision to prohibit FTA commercial broadcasters from offering multichannel services over DTT was largely driven by a desire to protect the pay-TV sector. Therefore, it is important to assess what the impact on pay-TV would be if this prohibition were now lifted.

The broadcast environment in Australia has changed dramatically since 1998. The deal between Foxtel, Telstra and Optus to allow Optus to resell the Foxtel service and Telstra to bundle that service with telephony has effectively reduced the number of mainstream pay-TV platforms from two to one. Optus is now effectively out of the business, operating as a pure reseller of pay-TV services. This has allowed, and will continue to allow, a considerable restructuring of Foxtel's cost base, including the renegotiation of its many supply contracts.

The industry's health is therefore considerably improved. Effectively, pay-TV in Australia can now be considered as a regionalised monopoly, which will reduce pressure on margins. At the same time, the pay-TV operators now have in excess of 1.5 million subscribers and generate revenues in excess of $A1.2 billion[28] annually, which is more than any individual commercial TV broadcaster.

The pay-TV sector as a whole is beginning to show positive returns: Austar is now profitable; and while Foxtel continues to make losses, this is at least partially due to the corporate structure and allocation of revenues within the pay-TV supply chain. Foxtel is a joint venture between News Corp, PBL and Telstra. A significant proportion of Foxtel's revenues are paid to its core program providers and controlling partners, News Corp and PBL, for the movie and sports channels. These content vehicles (Fox Sports and the Premium Movie Partnership) are profitable entities and are also owned largely by Foxtel shareholders.

Whilst pay-TV penetration remains at around 1.5 million households, growth has been steady. The launch of digital pay-TV by Foxtel is well underway and has provided the industry with additional impetus. Recent figures released by Foxtel show that churn has fallen to a record low and subscriber growth for the most recent quarter of FY04 was more than twice the pace of total subscriber growth.[29] As such, we believe it is hard to argue that the pay-TV industry in Australia remains a 'fledgling industry'. Whilst the market remains a long way from a low growth or 'utility' type mature structure, the pay-TV industry is now clear of its launch phase and has entered a phase of strong revenue and margin growth. It is therefore reasonable to investigate whether the relaxation of provisions designed to protect the sector will still have a significant effect on the industry.

8.2 Subscriber take-up

As discussed earlier in this paper, DTT multichannelling is likely to prove most attractive to households that do not currently have pay-TV but which would be attracted by a multichannel offering. Multichannel DTT effectively fills a 'gap' between the current 'premium' multichannel TV (pay-TV) offering and analogue terrestrial TV, by creating a low or no cost multichannel option.

The viewer statistics for the UK's Freeview platform support this[30]:

[28] Company data
[29] Company data, CSFB Analysis, August 2004
[30] EBU

- 75% of Freeview viewers are over 35 years old; 40% over age 55;
- 80% of viewing time still with the five terrestrial channels;
- Most attractive feature: one-off payment with no contract;
- Presence of BBC channels very important to 53%.
- Approval ratings are high (product rating, 70%; value for money, 72% recommend to friend, 80%);

There will inevitably be some overlap with the low-end of the pay-TV base. Some existing pay-TV customers may feel that a lower cost DTT multichannel proposition better, or more cost-effectively, serves their needs. However, the 'premium' segment of the pay-TV base will not be the target of DTT multichannel services, as DTT will not be offering much in the way of premium movies or sport. International evidence suggests that initially this impact is small. In fact, there is some evidence that pay-TV operators have put certain channels (e.g. SKY NEWS) on to DTT platforms, to encourage trial and migration to pay. They are treating multichannel DTT as a stepping stone to pay-TV.

The assessment that DTT multichannelling will fill a market position between existing free services and premium pay television offerings is also supported by Foxtel's recent figures showing that only 5% of Foxtel digital customers were taking the basic-only package compared with 20% prior to the introduction of digital, and that almost half Foxtel digital customers had taken the top package at year-end.[31]

Over time, as DTT penetration grows, the potential cannibalisation of DTH and satellite customer bases will become more acute. With an attractive, free / pay multichannel DTT offering in the market, viewers will have a real choice between 'premium' pay and DTT. In this environment, pay-TV operators will need to adopt a more sophisticated response. They have several options open to them.

In the UK, BSkyB will launch a free satellite bouquet of 112 channels (dubbed 'Freesat' by the industry). This is intended to ensure that free multichannel homes have a BSkyB set top box, allowing Sky to sell them occasional pay per view programming and to market pay upgrade deals to them. The Freesat concept has been developed in direct response to the success of Freeview in the UK. As a result BSkyB has upgraded its subscriber forecasts to 10 million by 2010 (excluding Freesat only viewers). Alternatively, pay operators could look to distribute some of their pay content via DTT, moving to more of a dual platform distribution approach.

Whatever option they adopt, it is difficult to argue that increased choice and service innovation, driven by competition, is bad for consumers. The long term effect on the financial health of pay operators, and Foxtel and Austar in particular, will depend on the quality of the strategic responses they develop to the growth of multichannel DTT. By the time DTT is strong enough to be a significant rival to pay-TV, pay-TV will have had several years to establish itself in a non-competitive environment.

In summary, considering the current size of the pay-TV sector, in the short to medium term it is unlikely that a DTT multichannel service will be a significant threat to Foxtel or Austar, though there will be some overlap between a DTT multichannel service and the existing services. In the longer term, the competitive overlap will increase, but pay-TV operators that adapt to this new environment will remain successful.

8.3 Competition for content

One concern of pay-TV operators is that multichannel DTT will increase competition for pay-TV content, including third party channels and sports rights.

[31] Company data, CSFB Analysis, August 2004

In the medium term, international evidence strongly suggests that some channels currently on the pay-TV platforms will be interested in gaining carriage on a DTT multichannel network, assuming DTT reaches critical mass. In particular, advertising funded channels will seek the greatest audience exposure possible and, in time, this could be on the DTT platform. The DTT platform could provide competition to the pay-TV networks which are currently the only distribution platform available to third party channels in Australia.

However, evidence of pure channel migration from cable / satellite to DTT is weak. Instead, channels are looking to move away from exclusivity and towards non-exclusive carriage by pay and DTT. This can be seen in the UK where channels such as SKY NEWS, SKY SPORTS 1 and QVC are carried by both platforms as well as both E4 and the Discovery Channel which are now carried on DTT's pay service ('Top-Up-TV') as well as pay-TV. BSkyB's SKY ONE is also considering carriage on the Freeview platform, as DTT penetration grows.

It is also a concern that pay-TV operators could face more effective competition for premium sports rights as a DTT multichannel platform would offer FTAs a greater opportunity to exploit rights. This is especially important in Australia as the anti-siphoning provisions require large volumes of sport to be carried by FTA broadcasters. The advent of DTT would lessen the need for FTAs to partner with Foxtel to secure rights as it would leave them better placed to offer a mix of free and pay sports distribution.

This is a potential negative for Foxtel. However, sports federations are unlikely to commit to important coverage on DTT exclusively until penetration levels are much higher. They are concerned as much about coverage as they are about revenues. DTT multichannelling could also introduce greater competition in rights negotiations for secondary channel exposure (e.g. a temporary dedicated Wimbledon channel).

In the medium term, DTT is likely to create a more even playing field for sports rights, with FTAs being more effectively able to compete with a Foxtel / FTAs team. Both groupings would be able to offer multichannel coverage including a mix of mass market FTA coverage and lower penetration free or pay coverage.

8.4 Summary

Over time, a successful Australian multichannel DTT service has the potential to attract a significant audience share. This will increasingly impinge on the bottom end of the pay-TV market, making it harder for Foxtel and Austar to attract the low spend basic tier customers.

In the short to medium term, we believe that this impact will be negligible, with DTT even helping pay-TV by promoting and demystifying the concept of multichannel TV. In the longer term, the competition between platforms is expected to become more acute as the overlap between their target audiences increases. However the very different natures of DTT and premium pay-TV propositions means that this competition will never be head of head. It is far more likely to be complementary, from a consumer's point of view, offering more choice, quality and service innovation.

Spectrum does not believe that the risk of competition in the longer term (especially competition that is expected to be beneficial to viewers and programme suppliers) provides a reason for the current prohibition of DTT multichannelling.

A final quote from Dawn Airey's address to the ABA Conference in June 2004:

"It is the viewer who is the ultimate beneficiary of more television, more innovation, more channels and more choice than ever before."

9 Impact of DTT multichannelling on other broadcasting stakeholders

9.1 Advertising and sponsorship

Over time DTT multichannelling is expected to contribute towards the trend of increasing premiums for mass market audiences, discussed on Chapter 7, potentially increasing overall costs for mass market advertisers. It will also make the TV advertising market more complex, increasing media buying costs. However, these effects will occur anyway, with multichannel DTT simply increasing the speed with which the TV market will develop along a route that has already been set.

However, the benefits of multichannelling to advertisers will also be accelerated, including the ability to reach smaller more targeted audiences (less waste) and the attraction of new ad categories and advertisers to the medium of television.

DTT multichannelling may have a small negative impact on Australian advertisers by contributing to audience fragmentation. This fragmentation is already underway and will continue. It is a trend present in all sophisticated TV markets globally. As channel choice increases, viewers will spend more time watching the non-mass market alternative channels. Advertisers themselves have also expressed support for the introduction of multichannelling in the AANA submission to the DCITA Multichannelling review.[32]

This loss of advertising share would be expected to be reflected in commercial FTAs' advertising rates on a pro-rata basis. However, there is evidence that CPTs have increased in multi-channel markets (see 7.2.1), as the FTAs command more of a premium for that scarce mass market audience. This potentially indicates less value for money for mainstream advertisers. We are likely to see this trend in the Australian market going forward as pay-TV takes an increased share of audiences. It is likely that audience fragmentation will be accelerated through the introduction of multichannel DTT.

However, offsetting this decrease of mass-market audience value are the benefits to advertisers of choice. Competition between media sellers allows buyers to negotiate harder and secure better rates, at least outside of the mass market. In addition, more segmented audiences allow advertisers to target specific demographics more effectively, with much less waste. The growth in Australian pay-TV advertising revenues over the last 12 months clearly indicates there is a growing appetite for this diversity.

In addition, smaller niche advertisers will be able to use television as an advertising medium where previously it was not feasible due to cost. Through DTT, new 'lower cost channels' will be available, targeting specific demographics, opening up the TV advertising market to lower budget advertisers.

The evolution of a settled three or four channel analogue TV market to a dynamic multichannel DTT, DTH and cable market creates upheaval and confusion. However in maturing markets such as the UK, most advertisers and media buyers would be loathe to go back to the monopoly days of the early Nineties, despite ITV's falling share and increasing premium or 'power ratio' (see Chapter 7). For most advertisers, the benefits outweigh the costs.

[32] AANA Submission, A response to DCITA regarding its digital TV review, July 2004

9.2 Production industry

The other stakeholder group that clearly demands consideration is the production community. Some market participants have argued that multichannel DTT would cause the level of local commissions to fall either due to increased competition (increasing programming costs), due to broadcasters diverting costs towards DTT or due to a reduction in available revenues driven in turn by audience fragmentation. They suggest that local content production (and the quotas that support them) would be especially vulnerable.

As discussed earlier, Spectrum believes that this concern is greatly overstated. In fact, we would argue that the development of a multichannel broadcast environment, whether or not supported by DTT, is more likely to provide benefits to the Australian production industry.

Spectrum expects that the channel line up for DTT in Australia would be similar to that seen elsewhere. That implies a mix of channels that are lower cost to produce. An analysis of the types of channels that might be offered, suggests that some new local content will be required. What additional original programming there is, is likely to be of a more innovative or targeted nature (such as for 2nd channels or international channels looking to localise). This represents an increase in overall production and the development of new lower cost production genres.

Exhibit 16: Likely impact of DTT multichannelling on local originated programming

Channel	Content	Proportion of local production
2nd channels of FTAs	Primarily low-cost extensions to existing programming	
Dedicated news channels	Primarily low-cost extensions to existing programming	
Children's channels	Low-cost extensions to existing programming (and international acquisitions)	
Niche channels e.g. travel	Little impact on local programming (international acquisitions)	
Community service channels	Some additional low-cost programming (and international acquisitions)	
International channels	Some local editing and additions required – funded by international channels	

Source: Spectrum Strategy Consultants

We predict that the increased cost of providing multichannel services is likely to be relatively small (see 7.3). As such, there is not necessarily a need for broadcasters to cut back on local production. Also, we have explained earlier why we expect real falls in advertising revenue to be small in the medium term.

DTT, as with multichannelling generally, will help the Australian production industry in another way. Traditionally, most content was only shown once. Channel capacity was limited and viewers frown on too many 'repeats' being shown on flagship channels. Multichannelling creates significant new broadcast capacity. One way this can be used is to package up and reshow programming as part of targeted niche services or to give viewers that missed the original broadcast a chance to catch up (time shifted or repeat focused TV).

This creates a viable domestic secondary market for programming, which increases the overall economic value of programming with a shelf life. Whether the secondary rights remain with the producer or are sold to the broadcaster, positive benefits will accrue to the production industry. Firstly, producers will stand to make greater returns from good programming. Secondly, the commissioning hurdle is reduced, since programmes potentially have more than one outing to recoup their up front costs.

9.3 Government

Finally, the impact of DTT multichannelling on the Government's broad objectives for the sector should be considered.

9.3.1 Government objectives

Section 3 of the *Broadcasting Services Act 1992* contains, amongst others, the following objectives:

- to promote the availability to audiences throughout Australia of a diverse range of radio and television services offering entertainment, education and information;
- to provide a regulatory environment that will facilitate the development of a broadcasting industry in Australia that is efficient, competitive and responsive to audience needs; and
- to ensure the maintenance and, where possible, the development of diversity … in the Australian broadcasting system in the transition to digital broadcasting.

Spectrum believes that each of these objectives would be serviced by the implementation of multichannel capability on the digital terrestrial platform.

International experience suggests that multichannelling certainly provides diversity, without compromising the quality of existing services. New services are often more than entertainment channels, with overseas niche services including news, childrens and popular science.

Creating competition in the pay-TV sector was a driver of pay television policy from its inception. To date, sustainable competition has not developed in the sector. Multichannelling also increases competition, providing an alternative to premium pay-TV for households that may be more price conscious. It gives viewers a greater range of options. Over time, this increased competition at the platform level reduces the likelihood that Government intervention is required to ensure fair competition and protect the interests of consumers.

Finally, multichannelling should help the Australian market in the transition to digital broadcasting. The successful launch of multichannel DTT will lead to more rapid take-up of digital, shortening the path to analogue switch-off (ASO). It will also reduce the ultimate cost of ASO, since more households will choose to move to digital rather than be subsidised, or even forced to switch. ASO provides the Government with the potential of releasing scarce (and potentially valuable spectrum) for other uses.

9.3.2 Broader impact of multichannelling

As discussed in Chapter 4, Spectrum also believes that multichannelling is both inevitable and generates significant positive benefits for viewers. DTT multichannelling will hasten this process, without creating significant negative impacts to any segment of the industry.

Spectrum does not believe that the advent of multichannelling is a threat to either the local production industry or the quantity or volume of local content aired on Australian commercial FTA channels (see 9.2). Even if this forecast is proved wrong, the appropriate way for the Government to intervene would be through public sector broadcasting (PSB) regulation and / or funding rather than through constraining an industry structure change that is demonstrated to deliver consumer benefits if successful.

A strong DTT market may also lead to enhanced economic activity in other industries in Australia:

- Product sales – the uptake of digital, regardless of platform, will require the sale of STBs, receiving equipment and potentially integrated digital televisions (iDTVs)
- Interactive services – the development of interactive services such as home banking, home shopping and play-along functionality provides potential for increased economic activity in execution and development
- Export potential – as markets globally become increasingly digital, the requirement to include enhanced/interactive elements in programmes for export will increase. Without the potential for such developments, Australia's production markets may become more marginalised

Finally, DTT could also improve the provision of additional non-broadcast Government services. In some markets, the deployment of services via digital television, for example health services in the UK (NHS Direct), has brought Government services to households that would have been excluded, because of geography or demographics, from services delivered by PC-based broadband.

Contact information

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About Spectrum

Spectrum was established in 1994 and works with the world's leading media and telecoms organizations to identify and take advantage of opportunities for innovation, growth, expansion and improvement.

Our mission is to provide outstanding service to our clients and to provide unequalled career opportunities to our staff.

We have carried out over 1,000 assignments in more than 40 countries throughout the world, and have regional offices in Brazil, Singapore and the UK, and associate offices elsewhere in Europe and Asia.

Our clients span the digital marketplace including broadcasting, fixed telecoms, mobile telecoms, music, new media and internet, education, the public sector, publishing and sport.

Our consulting services cover the following areas:

- Corporate and commercial strategy
- Financial advisory support
- Licensing
- Operational improvement
- Policy and regulation
- Rights management
- Strategic technology decisions
- Strategy implementation

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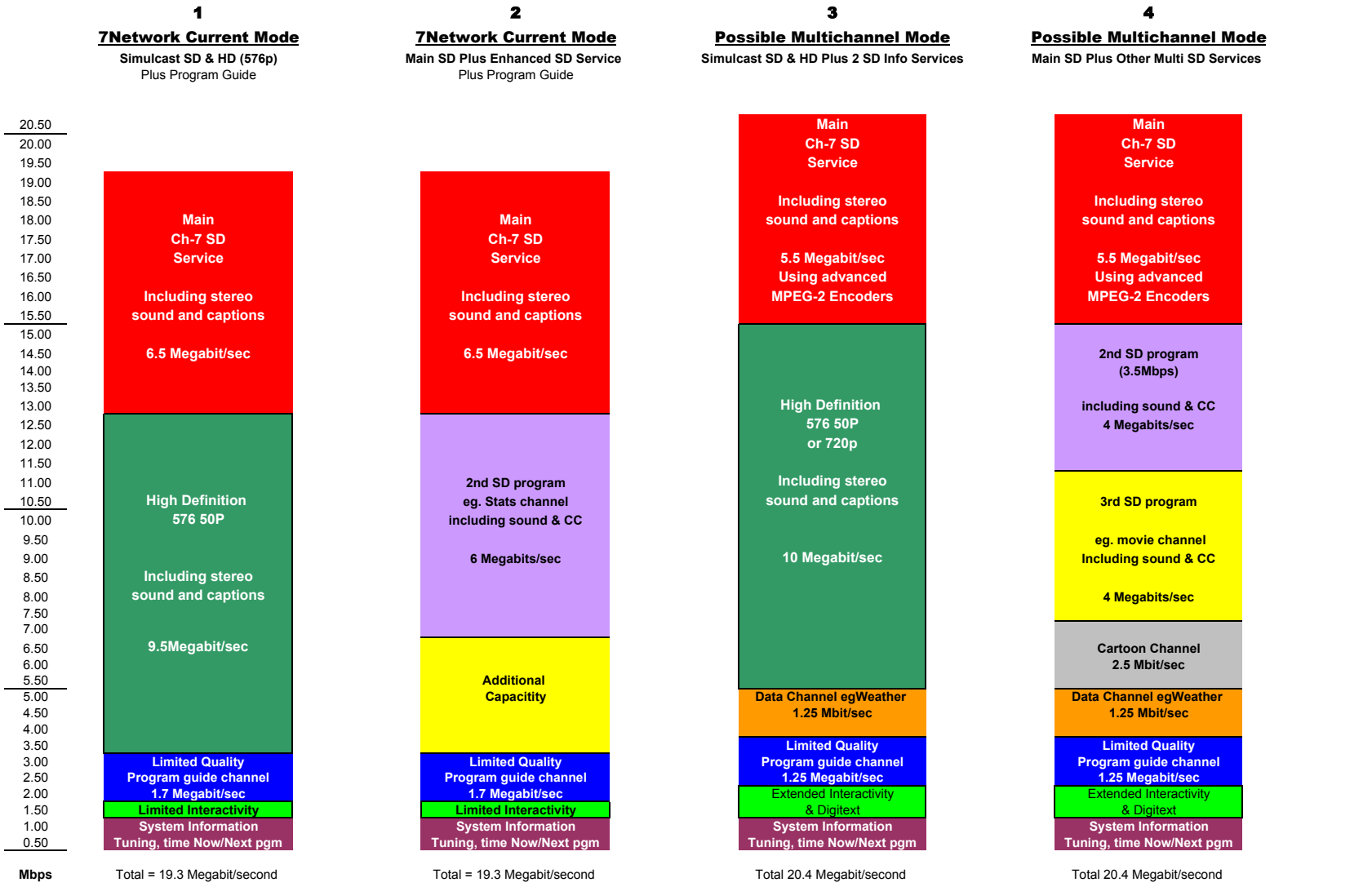
DCITA Multichannelling Review

Seven Network Submission August 2004

Appendix 3

Current 7 MHz Channel Capacity

7MHz Channel Digital TV Transmission Examples



DCITA Multichannelling Review

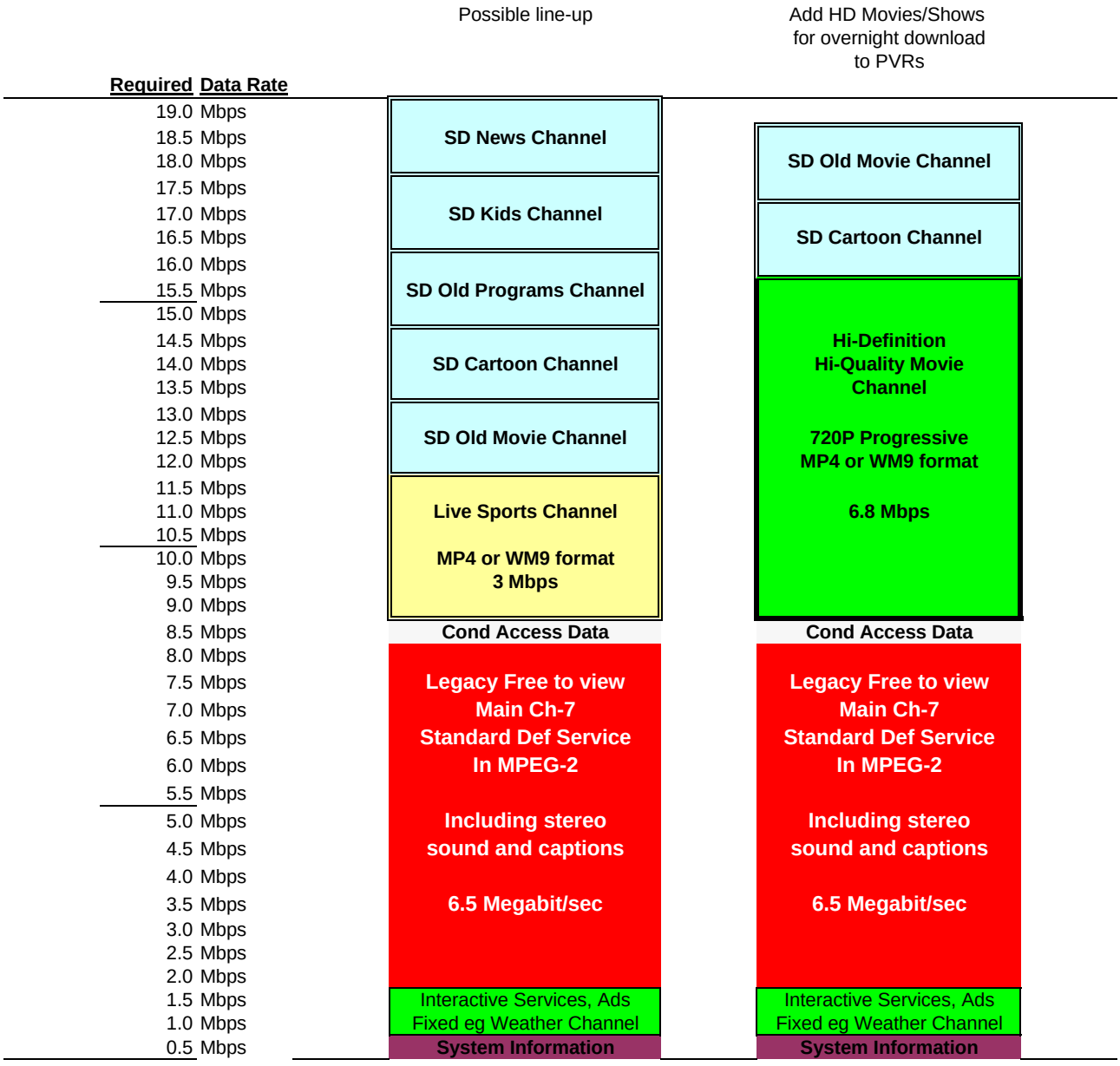
Seven Network Submission August 2004

Appendix 4

Potential 7 MHz Channel Capacity

Possible Extention of Program Services Offered on Digital Terrestrial

Using Receivers with MPEG-4 or MS Windows Media-9, suitable middleware and CA



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Appendix 5

DTT Services in UK, Germany and USA

Appendix 5

DTT Services in UK, Germany and USA

United Kingdom

Freeview TV

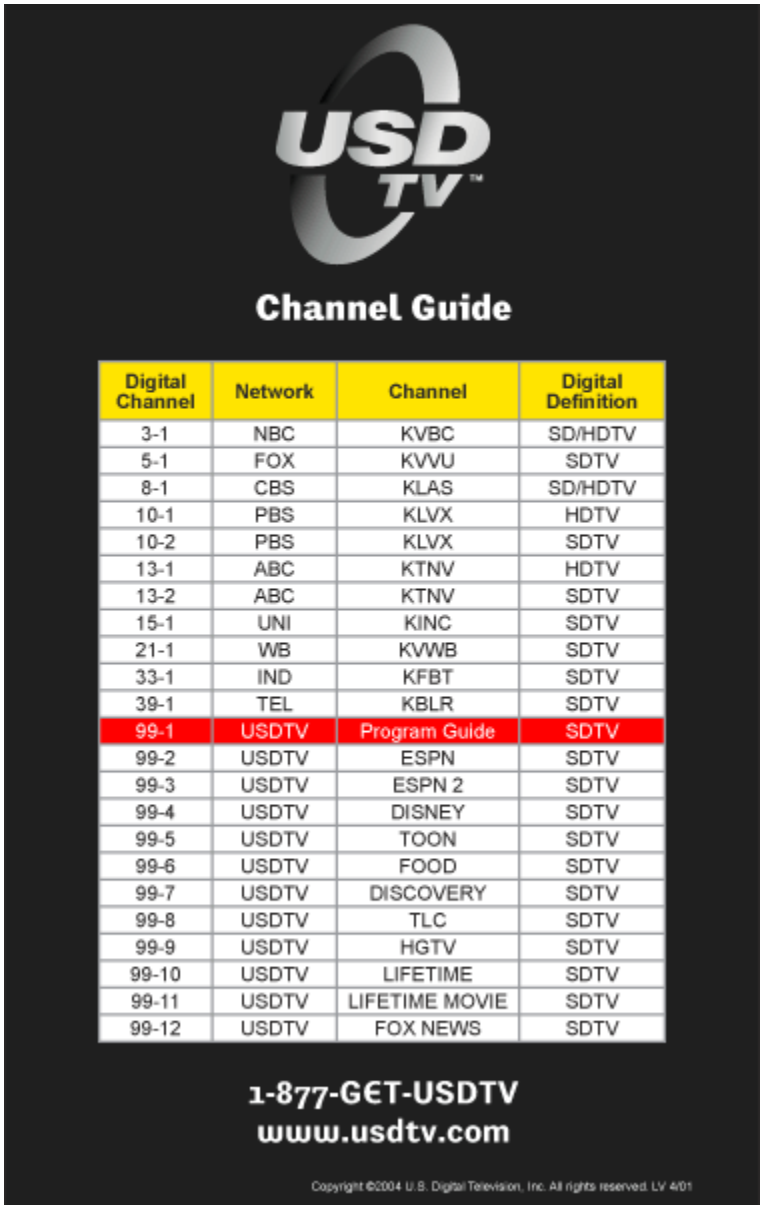
Freeview Radio

Top Up TV

Germany

USA

USDTV Channels Las Vegas



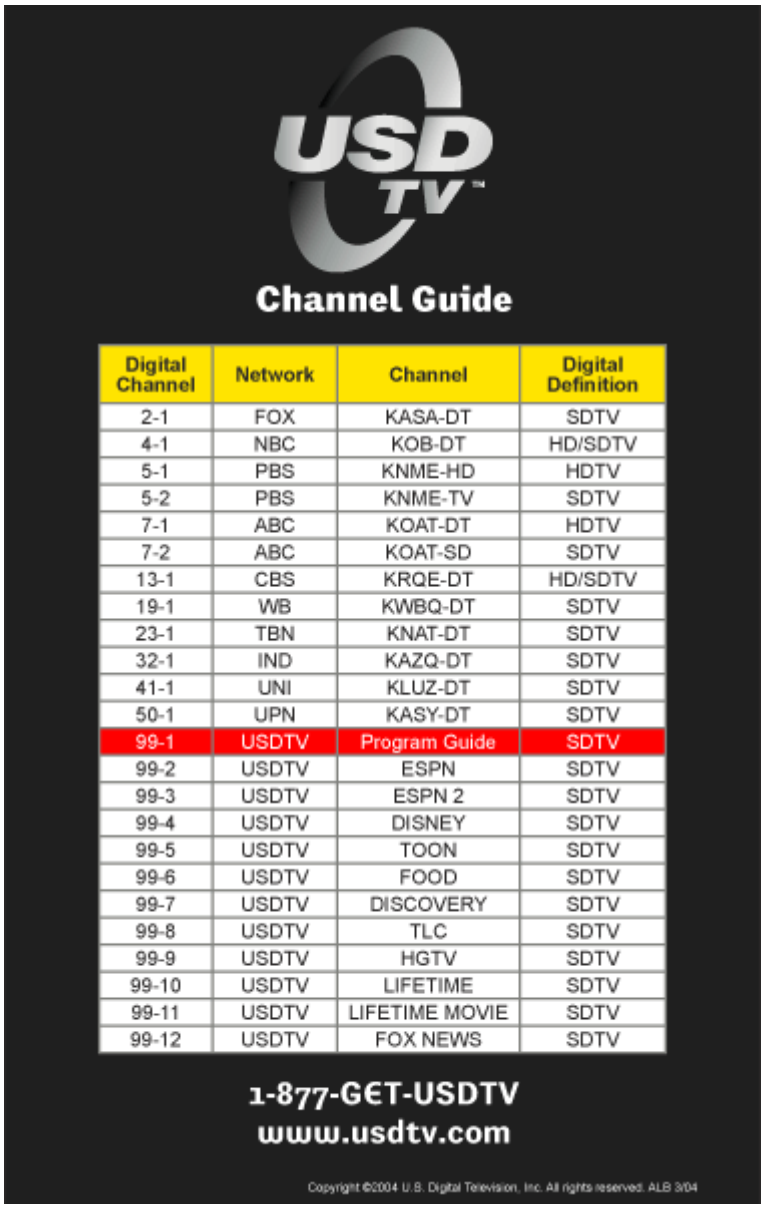
USDTV

Channel Guide

Digital Channel	Network	Channel	Digital Definition
3-1	NBC	KVBC	SD/HDTV
5-1	FOX	KVVU	SDTV
8-1	CBS	KLAS	SD/HDTV
10-1	PBS	KLVX	HDTV
10-2	PBS	KLVX	SDTV
13-1	ABC	KTNV	HDTV
13-2	ABC	KTNV	SDTV
15-1	UNI	KINC	SDTV
21-1	WB	KVWB	SDTV
33-1	IND	KFBT	SDTV
39-1	TEL	KBLR	SDTV
99-1	USDTV	Program Guide	SDTV
99-2	USDTV	ESPN	SDTV
99-3	USDTV	ESPN 2	SDTV
99-4	USDTV	DISNEY	SDTV
99-5	USDTV	TOON	SDTV
99-6	USDTV	FOOD	SDTV
99-7	USDTV	DISCOVERY	SDTV
99-8	USDTV	TLC	SDTV
99-9	USDTV	HGTV	SDTV
99-10	USDTV	LIFETIME	SDTV
99-11	USDTV	LIFETIME MOVIE	SDTV
99-12	USDTV	FOX NEWS	SDTV

1-877-GET-USDTV
www.usdtv.com

USDTV Channels Albuquerque



USDTV

Channel Guide

Digital Channel	Network	Channel	Digital Definition
2-1	FOX	KASA-DT	SDTV
4-1	NBC	KOB-DT	HD/SDTV
5-1	PBS	KNME-HD	HDTV
5-2	PBS	KNME-TV	SDTV
7-1	ABC	KOAT-DT	HDTV
7-2	ABC	KOAT-SD	SDTV
13-1	CBS	KRQE-DT	HD/SDTV
19-1	WB	KWBQ-DT	SDTV
23-1	TBN	KNAT-DT	SDTV
32-1	IND	KAZQ-DT	SDTV
41-1	UNI	KLUZ-DT	SDTV
50-1	UPN	KASY-DT	SDTV
99-1	USDTV	Program Guide	SDTV
99-2	USDTV	ESPN	SDTV
99-3	USDTV	ESPN 2	SDTV
99-4	USDTV	DISNEY	SDTV
99-5	USDTV	TOON	SDTV
99-6	USDTV	FOOD	SDTV
99-7	USDTV	DISCOVERY	SDTV
99-8	USDTV	TLC	SDTV
99-9	USDTV	HGTV	SDTV
99-10	USDTV	LIFETIME	SDTV
99-11	USDTV	LIFETIME MOVIE	SDTV
99-12	USDTV	FOX NEWS	SDTV

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HDTV is hot. USDTV gives viewers the ultimate viewing experience. They can enjoy their favorite broadcast TV programs and big TV events in HDTV and Dolby Digital 5.1 surround sound. Our set-top-box is fully ATSC compliant and functions as an "over-the-air" HDTV receiver.

USDTV will help build a digital audience for broadcasters.