FOXTEL

Submission to the
Productivity Commission

in connection with its

Review of National Competition
Policy Reforms

21 December 2004

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FOXTEL submission

Introduction

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

About FOXTEL

FOXTEL is Australia's leading subscription television provider.

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

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

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

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

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

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

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

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

1. Importance of taking a holistic approach to reform

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

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

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

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

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

Both the Australian Competition and Consumer Commission (***ACCC***)[2] and the Productivity Commission[3] have stated previously that the interconnection between these various arrangements mean that the reform of one should not be considered in isolation of its impact on others. Reform should instead only be considered in the context of a comprehensive review of all elements of the existing broadcasting regime.

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

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[1] BSA section 3(b).

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

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

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

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

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

2. Competition in the television entertainment market

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

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

- Evidence that consumers view open television, subscription television and video and DVDs as **substitutable** with one another. This evidence includes ratings data[5], levels of churn from subscription television providers back to open television and market research conducted by FOXTEL.
- Evidence to suggest that the price of open television (which appears to a consumer to be $0) **constrains** the prices subscription television providers are able to charge for their services and has kept subscription television prices relatively stable.
- The **actions and views** of open television broadcasters,[6] subscription television providers and video and DVD retailers that suggest that they perceive one another as competitors.
- Direct and vigorous competition between open broadcasters and subscription television providers (and channels) to acquire and retain the most attractive **content**.
- The methods used by open broadcasters, subscription television providers and video and DVD retailers (and their industry bodies) to **sell and promote** their respective products.
- The significant resources expended by open broadcasters and subscription television providers to **advocate** change of, or the maintenance of, Commonwealth regulation of the television industry.
- Responsive **content** and **product developments** by open broadcasters, subscription television providers and video and DVD retailers. For example:
  - in response to the broadcast of *Law & Order* on the FOX8 subscription service at 8.30pm on Sunday evenings, Network Ten stopped showing movies at 8.30pm on Sundays and scheduled in their place *Law & Order: SVU*;

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

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

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

There has been discussion in the context of the Multi-channelling Review about the significance of changes to the subscription television industry since 1998 and the success of the FOXTEL and AUSTAR Digital services launched in March 2004[8]. FOXTEL agrees that subscription television has made some substantial achievements in the last few years and that the launch of the FOXTEL Digital and AUSTAR Digital services has confirmed that subscription television providers are the primary innovators in Australian television. However, these achievements do not equate to profitability and FOXTEL, the largest subscription television provider, remains loss-making. The FOXTEL Digital service that was launched in March 2004 is still in its development phase following an investment of approximately $600 million, the biggest single investment in digital conversion by any Australian television broadcaster.

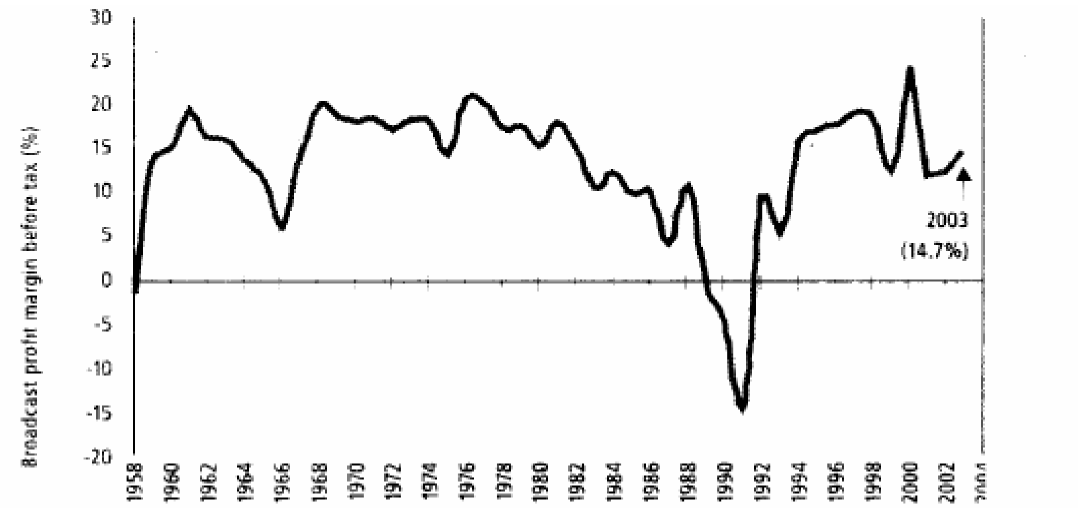
Notwithstanding the appeal of the FOXTEL and AUSTAR Digital services and subscription television generally to growing numbers of Australians, the commercial open broadcasters continue to dominate the television entertainment market and subscription television is yet to reach a viable and long-term sustainable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

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

[7] *Ad News*, 3 December 2004

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

Broadcast profit margin before tax of Australian commercial television stations, fiscal 1958-2003[9]



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

According to the most recent AFC statistics[10], subscription television broadcaster operating losses for the 1996/97 financial year were $1,058.4 million, for 1999/00 were $675.8 million and for 2002/03 were $451.5 million..

Other indicia of market power - audience penetration, share of total advertising expenditure, share of viewing and television and programme acquisition practices - all, similarly, point to the market dominance of the incumbent commercial television broadcasters[11].

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

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

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

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

[12] ACCC 2003 Report at pg xvi

In particular, the commercial broadcasters benefit from:

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

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

> "*An ABN AMRO report on the media sector released in July 2002 noted that the operating margins of Australia's major FTA television companies (at an average of 28 per cent) were among the highest in the world (global average of 18 per cent). The report commented that this was the result of the benefits provided by the current regulatory structure of the Australian FTA industry.*
>
> *"A more recent report released in June 2004 forecasted an industry EBIT margin of 27 per cent for the 2004/05 financial year, with continuing margin expansion projected for the ext two years reaching in excess of 30 per cent by the 2007/08 financial year. It also noted that industry pre-tax profit margins are near the upper limit of their 10-20 per cent long term range and that FTA sector EBIT margins are above the other main media sub-sectors."*[13]

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

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

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

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

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

Commercial open broadcaster multi-channelling, either "free-to-air" or subscription, will advantage Seven, Nine and Ten as against subscription television providers particularly in the area of programme acquisition. The disparity between existing commercial open broadcaster and subscription television channel budgets puts subscription television at a significant disadvantage when negotiating with rightsholders for attractive programming[15].

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

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

In the 2004 financial year, Australia’s commercial television networks had combined revenues of approximately $2.66 billion[16], compared with $1.2 billion[17] for subscription television operators . The disparity is even more notable considering the much wider cost base subscription television operators must support, including customer receiving equipment and customer service, and the cost of acquiring programming (including, in the case of FOXTEL and AUSTAR, more than 100 channels carried on their digital platforms).

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

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

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

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

[17] Source: CEASA and FOXTEL Analysis

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

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

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

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

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

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

The FOXTEL Digital and AUSTAR Digital services were launched in March 2004 at a cost of deployment of approximately $1 billion - substantially more than the estimated $600 million spent on converting the terrestrial television sector to digital[18].

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

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

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

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

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

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

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

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

5. FOXTEL recommendations

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

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

6. A revised Productivity Commission proposal

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

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

Schedule 1

Submission to Government on the provision of services other than simulcasting by free-to-air broadcasters on digital spectrum

20 August 2004

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Introduction

This is a submission by FOXTEL Management Pty Limited (FOXTEL) in response to the issues paper released by the Department of Communications, Information Technology and the Arts (***Department***) on 10 May 2004 concerning the provision of services other than simulcasting by the commercial broadcasters on terrestrial spectrum.

This submission primarily concerns the subject of possible digital terrestrial multi-channelling by the commercial broadcasters.

Executive summary

The introduction of digital terrestrial multi-channelling by the existing commercial broadcasters is being considered as a possible driver of digital broadcasting take-up in Australia.

However, the policy issue of terrestrial multi-channelling by the commercial broadcasters cannot be considered in isolation from its inevitable impacts on the other key broadcasting regulatory issues, in particular the moratorium on a 4th commercial television broadcasting licence, and the restrictive anti-competitive regulation of sports broadcasting through the “anti-siphoning” regime.

FOXTEL would not oppose digital terrestrial “free” multi-channelling” by the commercial broadcasters after 2008 – as long as it is introduced as part of a comprehensive rebalancing of the television broadcasting regime.

For the reasons set out in this submission, FOXTEL’s position is as follows:

- **There must be a minimum four year period from March 2004 (the date of commencement of major digital subscription television services in Australia) until March 2008, during which there is no permitted “free” terrestrial multi-channelling by the commercial broadcasters.**

- **The only service the commercial broadcasters should be entitled to provide on the publicly-owned terrestrial spectrum loaned to them should be “free” so that all members of the public can access and benefit from it.**

- **The anti-competitive regulation of sports broadcasting through the “sports anti-siphoning” regime must be abolished - prior to the enabling of any “free” terrestrial multi-channelling by the commercial broadcasters.**

- **Simulcast and HDTV requirements should be retained, as complementary drivers of digital television take-up.**

Overview

FOXTEL supports the policy objectives of the *Broadcasting Services Act 1992* (***BSA***) and, in particular, its aim:

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

FOXTEL actively promotes these objectives by competing in the television entertainment market with the national broadcasters, the commercial broadcasters, DVD and video sales and rentals and other subscription television providers. The commercial broadcasters dominate this market.

Growing and sustainable competition, that promotes the objectives of the BSA, can only exist on a regulatory playing field where none of the players are uniquely advantaged by Government-provided benefits.

In addition, large scale investment - such as that required to support digital broadcasting - is best promoted by stable and reliable policy and regulatory environments that support all participants equitably.

Currently, competition in the television entertainment market is not conducted on a level regulatory playing field and it is affected by different regulatory regimes that apply to each of the participants in the market. Direct regulatory change affecting one group of participants will have a "knock-on" effect on the ability of other participants to compete.

Therefore, any major regulatory change must be considered in terms of its whole-of-industry impacts. FOXTEL agrees with the view put by the ACCC in its June 2004 *Submission to the Productivity Commission Review of National Competition Policy Arrangements* (***ACCC 2004 Report***) which says: "The various regulations applying to the pay TV and FTA sectors should not be considered in isolation but should be considered in the context of a comprehensive review"[2].

Consequently, possible terrestrial multi-channelling by the commercial broadcasters cannot be considered in isolation from the other key broadcasting regulatory issues, in particular the

[1] BSA section 3(b)

[2] ACCC 2004 Report, p25

moratorium on a 4th commercial television broadcasting licence, and the regulation of sports broadcasting through the "anti-siphoning" regime.

The introduction of terrestrial digital multi-channelling is being considered as a possible driver of digital broadcasting take-up in Australia.

However, in considering whether a major regulatory change such as terrestrial multi-channelling should be enabled, an assessment of the effectiveness of the existing digital television broadcasting regime in promoting digital take-up and competition is needed.

Despite weaknesses in parts of the competition framework, the existing digital broadcasting regulatory environment is delivering a growing level of investment, competition, employment, and consumer services.

The new digital subscription television services launched in early 2004 by FOXTEL and Austar, and the subscription television channel community – through the combined investment of more than $1 billion - are driving innovation, growing competition in the television entertainment market and achieving digital television take-up by consumers.

Without a robust and sustainable subscription television sector, there would be little motivation and competitive market pressure for the dominant commercial broadcasters to invest in new and innovative digital services for consumers.

The FOXTEL Digital and Austar Digital services are particularly important among the existing market forces promoting growth in digital television take-up in Australia. Their launch has galvanised the commercial and national broadcasters to grow and improve their digital services and inspired renewed competition from DVD and video content distributors[3].

Existing market forces, and digital investments, will continue to build new services and drive digital take-up, as long as no further competition imbalances are imposed on the market via the isolated enabling of multi-channelling by the commercial broadcasters.

However, industry needs the equitable provision of regulatory certainty and stability by Government to support the sustainability of existing digital investments, and to give the market and investors a level of certainty in planning future investment.

[3] We note in particular the current advertising campaign being promoted by the Australian Video Retailers Association (see section 3.1)

The Government and the Federal Parliament have already set a precedent for providing defined periods of regulatory certainty for digital broadcasting investment by giving the commercial broadcasters a set time to establish their digital investments by banning a 4th commercial network until at least 2007.

The progress being made under the existing regulatory framework should not be put at risk by any large scale regulatory change such as multi-channelling by commercial broadcasters – which would further tilt, rather than act to balance, a regulatory playing field that is already slanted in favour of the commercial broadcasters which dominate the market, assisted in part by unique, Government-conferred benefits such as Australia's sports broadcasting regulations.

The ACCC has noted that already the commercial open broadcasters "are provided a level of protection from competition that is not given to firms in other industries"[4].

As Frontier Economics concludes in a paper attached to this submission:

"The broad thrust of pro-competitive microeconomic reform over the past two decades has drawn many lessons on how competition can be fostered. One of the principal lessons from this broader experience is that competition must occur on a level playing field: unnecessary regulatory barriers must be reduced, and uncosted, Government-conferred benefits should be removed. Otherwise, resources are likely to be misallocated throughout the economy, and overall social welfare will be reduced."

FOXTEL's position - summary

"Free" multi-channelling by the commercial broadcasters

FOXTEL would not oppose digital terrestrial "free" multi-channelling" by the commercial broadcasters after 2008 – as long as it is introduced as part of a comprehensive rebalancing of the television broadcasting regime.

In particular, anti-competitive sports broadcasting regulation through the sports "anti-siphoning" system must be abolished first.

In terms of timing, any regulatory change in relation to "free" multi-channelling by the commercial broadcasters must give subscription television an equitable opportunity to that given to the commercial broadcasters to establish their digital investments.

[4] ACCC report on *Emerging market structure in the communications sector*, June 2003, p xvi

The Government has consistently justified its ban on new commercial television broadcasting licences until at least 2007 on the basis that the commercial broadcasters must first have a period of time (specifically, 6 years measured from the date upon which the commercial broadcasters commenced digital transmissions in January 2001) to establish their digital investments without major regulatory change in their environment[5].

FOXTEL advocates a minimum four year period from March 2004 (the date of commencement of major digital subscription television services in Australia) until March 2008, during which there is no permitted "free" terrestrial multi-channelling by the commercial broadcasters.

Subscription terrestrial multi-channelling

The commercial broadcasters were given the privileged loan of publicly-owned spectrum, and given legislative protection against further commercial network licences, in return for providing "free" digital television to all Australians in metropolitan, regional and rural Australia.

There would be no public benefit in enabling the transformation of the terrestrial television system from a "free" television model into a "pay" television model for the exclusive use of the existing commercial broadcasters.

The only service the commercial broadcasters should be entitled to provide on the publicly-owned terrestrial spectrum loaned to them should be "free" so that all members of the public can access and benefit from it.

Restrictive sports broadcasting regulation

Australia's restrictive sports broadcasting system known as the "anti-siphoning" regime continues to preserve far more hours of sports for terrestrial broadcasters than they ever transmit, which is contrary to the entire justification for the system, which was to protect "free" television coverage of major sporting events that Australians had become accustomed to viewing.

FOXTEL actively promotes the pro-consumer objectives of the BSA by competing in the television entertainment market with the national broadcasters, the commercial broadcasters, DVD and video sales and rentals and other subscription television providers. The commercial broadcasters dominate this market.

[5] Explanatory Memorandum, *Television Broadcasting Services (Digital Conversion) Bill* 1998 (***Explanatory Memorandum***), Item 1

Subscription television's ability to compete in this market is severely limited by the "anti-siphoning" system which gives a massive competitive advantage to commercial broadcasters over subscription television in acquiring sports rights. The system also gives the commercial broadcasters artificial negotiating advantage over sports rights owners and sporting organisations to the ultimate detriment of the wider sporting community and consumers, as described by the Productivity Commission[6].

To give the commercial networks the new advantage of multi-channelling, without first correcting the inequity of the anti-siphoning system, would not only multiply the destructive impacts of the system on competition from subscription television. It would also deepen and entrench the harmful impacts the system already has on the ability of sporting organisations to gain fair value for their rights, and aggravate the resultant detriment to the sports participating community and consumers.

The anti-competitive regulation of sports broadcasting through the "sports anti-siphoning" regime must be abolished **-** prior to the enabling of any "free" terrestrial multi-channelling by the commercial broadcasters.

Possible 4th commercial broadcasting network

The matter of a possible 4th commercial broadcasting network is one for Government to determine by weighing the pros and cons of consumer impacts and industry competition impacts.

However, FOXTEL makes the following observation in relation to a possible 4th commercial network.

The Government needs to decide whether or not a 4th commercial television broadcasting service should be introduced – prior to making any decisions in relation to terrestrial multi-channelling by the incumbent commercial broadcasters.

This is because permitting "free" multi-channelling by the incumbent commercial open broadcasters would be the equivalent of issuing them with new commercial television broadcasting licences. While FOXTEL is neither advocating nor opposing a possible 4th commercial open broadcaster, if Australia is to have a sustainable 4th commercial broadcasting service, it is only logical that it must be launched and given time to establish before multi-channelling is allowed by the existing entrenched and dominant market participants – the commercial broadcasters. Otherwise these broadcasters will be given an even greater first mover advantage over the 4th commercial broadcaster than they already have via their incumbency – because they will be able to capture available programming and advertising revenue for their multi-channels first, removing any sustainable market opportunity before the new entrant arrives.

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[6] Productivity Commission, *Broadcasting Inquiry Report*, released 3 March, 2000 (***Productivity Commission Report***) p 435-437

Introduction to FOXTEL

FOXTEL is Australia's leading subscription television provider.

It commenced distributing its services on cable with 20 channels in 1995, expanding to 31 channels and satellite distribution in 1999 and increased its offering to 45 channels in 2002 following the completion of the FOXTEL-Optus Content Supply Agreement (***CSA***)[7]. FOXTEL is now available to more than 70% of Australian homes, with more than 1.1m homes currently connected to the FOXTEL service directly or by receipt of services provided on a wholesale basis to other providers such as Optus TV.

In March 2004 FOXTEL launched its FOXTEL Digital service, giving Australian viewers the choice of more than 100 digital channels. These channels are provided by 50 different Australian and international media and communication companies, 20 of which are Australian-owned or Australian-based.

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

In addition, independent channel providers are able to access the FOXTEL analogue and digital distribution networks, and through them access the FOXTEL subscriber base independently of the FOXTEL service, through FOXTEL's digital and analogue access regimes, which have been accepted by the ACCC.

FOXTEL directly employs over 1,800 people and a further 1,400 workers are indirectly engaged by FOXTEL in sales and installation services nationally.

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

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

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[7] Content Supply Agreement executed by FOXTEL Management Pty Limited, Singapore Telecommunications Limited et al on 5 March 2002.

FOXTEL is jointly owned by Telstra Corporation Limited (50% equity), The News Corporation Limited (25% equity) and Publishing and Broadcasting Limited (25% equity).

1. The policy objectives of the digital television regulatory regime

FOXTEL supports the competition principles that underpin the policy framework of the *Broadcasting Services Act 1992* (***BSA***) and, in particular, its aim:

> "*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*"[8]

When the Federal Parliament enacted the *Television Broadcasting Services (Digital Conversion) Act 1998* (the ***1998 Act***), it put in place a package of regulatory arrangements that provided for, among other things:

- the loan to open broadcasters of spectrum in which to simulcast their existing analogue services in both standard and high definition digital terrestrial formats for a designated simulcast period, before returning their analogue spectrum to the Government;
- prohibitions on commercial open broadcasters' use of that spectrum for terrestrial multi-channelling; and
- a moratorium on the issuance of new commercial television broadcasting licences until at least 2007.

The restraints on competition included in the regime were, in Federal Parliament's view, necessary to address the following objectives:

- a phased transition from analogue to digital television broadcasting and transmission to avoid disruption to consumers in metropolitan and regional areas;
- maximisation of the use of existing transmission infrastructure;
- the introduction of digital terrestrial television broadcasting services within a timetable to ensure that Australia did not fall significantly behind the rest of the world;
- optimisation of viewer choice and diversity of product (recognising the role of community television services and Australian content in this regard) across free-to-air and subscription services; and
- achieving "competitive neutrality" between open broadcasting, pay TV and other communications sectors[9].

[8] BSA section 3(b)

[9] Explanatory Memorandum sB6

A key factor in the legislation was the competitive balance it sought to achieve through the protection given to the digital investments of the open broadcasters (by way of the moratorium on new commercial television broadcasting licences until at least 2007), on the one hand, and the prohibition against terrestrial multi-channelling by the open broadcasters (to enable the emerging subscription television sector to become established), on the other.

The regimes set out in the 1998 Act are now under review, as required by the BSA. Any reforms that may stem from the reviews should be carefully tailored to further the policy objectives of the BSA and consumer benefit by promoting sustainable competition in the television entertainment market.

If the Government decides that these objectives can be furthered by allowing “free” digital terrestrial multi-channelling by the commercial broadcasters on spectrum loaned to them to provide digital services, reforms to this effect should be introduced as part of an across-the-board balancing of the television broadcasting regime (including introduction of a fundamentally competitive sports broadcasting regime) after subscription television has had a reasonable period to establish its digital investment (of not less than four years) and after the Government has decided whether or not to issue a 4th commercial television broadcasting service licence.

This submission sets out FOXTEL's recommendations concerning the possible introduction of terrestrial multi-channelling in more detail (at section 7.2).

2. Importance of taking a holistic approach to reform

The existing digital television regime comprises a number of regulatory arrangements (including those described in section 1) that together create the regulatory environment in which participants in the television entertainment market compete.

The interrelationships between these various arrangements has been recognised by both the Productivity Commission[10] and the ACCC, which noted in the ACCC 2004 Report that "the various regulations applying to the pay TV and FTA sectors should not be considered in isolation but should be considered in the context of a comprehensive review"[11].

Consistent with the views of the ACCC and the Productivity Commission, FOXTEL believes that commercial open broadcast terrestrial multi-channelling and its effects should be considered in the context of all other regulatory arrangements relating to the television broadcasting services, including the moratorium on a 4th commercial television broadcasting licensee and anti-siphoning restrictions affecting the acquisition of sports programming.

Analysis by economists Frontier Economics concurs with the Productivity Commission and the ACCC that regulatory reform needs to be assessed holistically. Attached as schedule 1 to this submission is an independent paper prepared by Frontier Economics at FOXTEL's request which identifies the key regulatory arrangements comprising the digital television regime and ways of advancing the policy objectives of the BSA.

Frontier Economics concludes:

> *"Focusing on a particular policy question in isolation (for example, the details of the simulcast requirements) without taking into account the implications for broader questions of competition in the industry or previous regulatory commitments, risks a failure to meet the objectives of the Act.*
>
> *"The digital television reviews to be undertaken by the Department risk making changes to the television broadcasting industry in a piecemeal, uncoordinated fashion with a corresponding risk of serious systemic failure. A framework for analysis must be established, which focuses on the Government's objectives, and employs a coordinated strategy for meeting these objectives. Such a coordinated*

[10] Productivity Commission Report p 254

[11] ACCC 2004 Report p25

strategy is only possible if the interrelationships between existing policy measures are taken into account.

"The issues raised in the Department's issues paper on multi-channelling are in essence the following: what should the commercial open broadcasters be entitled to do with the digital spectrum that was lent to them to convert to digital? The answer to this question depends on the answer to an even more fundamental question: how is competition best encouraged in the television broadcasting industry, without sacrificing other policy objectives?"

While the three issues papers released by the Department to date in connection with the digital television reviews[12] acknowledge that there are likely to be links between the 11 statutory reviews being conducted in 2004 and 2005, each paper appears to consider regulatory change in narrow terms.

FOXTEL is therefore concerned that through the issuance of separate digital policy discussion papers, the issues may be considered in a segregated manner that will not be conducive to the comprehensive analysis fundamentally needed to determine regulatory reforms that would lead to sustainable, improved competition.

As a first step, a comprehensive review of the success or otherwise of the digital television regime to date should be conducted to measure the progress of digital television against the Federal Parliament's policy objectives, by looking at:

- the level of competition in the relevant market;
- existing drivers of digital television take-up in Australia;
- consumer benefits derived from digital television services and their rollout; and
- other relevant public policy considerations as to efficiency in the use of spectrum and of the broadcasting sector itself.

The following sections 3 and 4 address these issues.

[12] Issues paper on *The provision of services other than simulcasting by free-to-air broadcasters on digital spectrum* released on 10 May 2004; issues paper on *The viability of an indigenous television broadcasting service* released on 10 May 2004; and issues paper on *The provision of commercial television broadcasting services after 31 December 2006*, released on 13 July 2004

3. Competition in the television entertainment market

3.1 The market

The market regulated by the digital television regime is the television entertainment market, in which commercial and national television broadcasters, subscription television operators and video and DVD retailers all compete for Australian viewers[13] and share of television use by consumers.

Suppliers of television entertainment to Australian homes include the following:

- ***national broadcasters***
    - the ABC and SBS
- ***commercial broadcasters***
    - the Seven, Nine and Ten networks and their regional affiliates
    - currently, 48 commercial television broadcasters report revenues and pay commercial television broadcasting service licence fees to the ABA
- ***subscription television***

    The subscription television sector includes the following participants:

    - platform operators, including FOXTEL, Austar, Optus, Neighborhood Cable and TransACT (TARBS went into receivership in July 2004)
    - FOXTEL service resellers, AAPT, Telstra and TransACT
    - channel suppliers; on the FOXTEL Digital service alone, the channels offered are owned by 50 different media and communication companies, including 20 Australian owned or Australian based companies

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[13] The fact that these service providers are competitors has been acknowledged recently by the Australian Broadcasting Authority (***ABA***), Commercial Television Australia (now known as Free TV) and the Australian Video Retailers Association (***AVRA***):

- In response to a question from the floor at the Policy Session of the ASTRA Conference held in Sydney on 7 April 2004, Lyn Maddock, then Deputy Chair of the ABA, confirmed that competition to FOXTEL comes from "everyone from DVD players and director cinema tickets to free-to-air [television]";
- Julie Flynn, CEO of Free TV Australia, said on ABC Radio National (18 May 2004) "so we are now competing against a much stronger digitised and merged FOXTEL operation in the pay TV sector. Plus there's DVD's, the Internet, computer games, all competing for people's eyeballs, people's time and for the same amount of revenue"; and
- In its April 2004 newsletter, AVRA described the commencement of the FOXTEL/Austar digital service, including the FOXTEL Box Office movie channel, as "the biggest current threat to our industry since Pay-TV" and AVRA's current advertising campaign positions videos and DVDs in head-to-head competition with subscription television. A copy of the AVRA flyer titled "*Thinking of paying for digital PAY-TV?*" which was available in DVD/video stores on and around 1 July 2004 is attached as Exhibit A

- third party channels; who can obtain access to FOXTEL's analogue and digital cable system and set top units (and therefore access to FOXTEL's entire subscriber base) under fair and transparent arrangements accepted by the ACCC[14]

At the date of this submission, there are approximately 40 members of the Australian Subscription Television and Radio Association (***ASTRA***), comprising primarily independent channel providers and platforms.

- ***video and DVD retailers and rental operations***
  - 1615 video and DVD rental outlets in 2002[15]
  - around 60% of these are represented by AVRA[16]
  - among the remaining 40% (approximately) are members of the major Blockbuster and Video Ezy chains[17]
  - in addition, major retail store chains sell video tapes and DVDs

3.2 The state of competition in the market

All market indicators confirm that the television entertainment market continues to be dominated by the commercial open broadcasters.

- ***Penetration***

  Commercial broadcasting services are received by over 98% of Australian households[18]. By comparison, subscription television services in Australia are connected to approximately 24% of homes[19].
- Regarding VCR and DVD player ownership, in 2003, 87% of homes in metropolitan areas owned one or more VCRs while the proportion of households with a DVD player had jumped from 12% in 2001 to 51% in 2003[20].

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[14] Pursuant to FOXTEL's section 87B undertakings given in connection with the CSA.

[15] ABS, *Video Hire Industry*, May 2001.

[16] AVRA, *AVRA Members*, available at www.avra.com.au.

[17] AVRA, *AVRA Launches National Pro members Rental Campaign*, 24 May 2004.

[18] Free TV Australia Media Release, 10 June 2004.

[19] ABA website, FAQ

[20] Australian Film Commission report "*Get the picture"* www.afc.gov.au/gtp/wvauver.html accessed 22 July 2004 (***AFC Report***)

- ***Profitability***

In the last reported financial year (2002-2003), the combined EBITDA of the three commercial television networks and their affiliates stood at $844 million[21] on $3.45 billion in revenues[22], resulting in an average margin of 24.5%[23].

Over $8 billion has been invested in the subscription television industry since 1995[24], however subscription television operators have yet to reach profitability. Annual revenue for the subscription television sector is in excess of $1.5 billion[25]. However, all the major operators (including FOXTEL, Optus TV and Austar) have made, and continue to make, losses.

Following its $600 million digital investment, which has taken the total investment in FOXTEL since launch in 1995 to more than $1.5 billion, FOXTEL projects it will become cash flow positive by calendar mid-2006[26].

Annual revenues from retail sales of video tapes and DVDs in 2003 amounted to $817.7 million[27] while wholesale revenues (deriving from sales and rentals to video and DVD retail and rental outlets) for 2003 were $978.6 million. Businesses in the video and DVD sales and rental industry in 1999-2000 recorded an operating profit before tax of $42 million representing an operating profit margin of 7.2%[28].

- ***Share of viewing and television usage***

Commercial and national broadcasters control around 86% of total broadcast viewing in Australian households. By comparison, subscription television controls approximately 14% of broadcast television viewing in Australian households[29].

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[21] Coleman, G *The Consequences of Technological Change*, presentation of ABA Conference, June 2004

[22] ABA Media Release, *Broadcasting Financial Results for 2002-2003,* NR 40/2004, 4 May 2004

[23] Coleman, G *The Consequences of Technological Change*, presentation of ABA Conference, June 2004

[24] FOXTEL Media Release, 13 November 2002

[25] IBIS*World* report, *P-9124 – Pay Television in Australia,* published 19 May 2004]

[26] Kim Williams, presentation to the Australia Israel Chamber of Commerce, 27 May 2004

[27] AFC Report

[28] Australian Bureau of Statistics Report, *Video Hire Industry 1999-2000* (***ABS 2000 Report***)

[29] OzTAM, Metropolitan Total TV Share of All Viewing – All Homes (A2) (***OzTAM Release***) 1 July 2004

In the television entertainment market, competition for use of the television in the home includes DVD’s and videos. DVD and video is not subject to the same level of detailed daily analysis provided for open broadcast and subscription television viewing that is provided by the OzTAM/ATR audience measurement system. However, DVD and video are clearly major competitors in the television entertainment market.

Recent media reports have said that VCRs account for 9% of overall television usage time and DVDs account for 8%[30]. On this basis, 17% of all television usage is attributable to DVDs and videos.

The ABS 2000 Report (the most recent report on the video and DVD industry prepared by the Australian Bureau of Statistics) estimated that more than 152 million video rental transactions were made by businesses in the video hire industry during 1999-2000, representing an average of eight transactions per Australian.

Critically, the digital medium DVD is fast growing in terms of penetration, providing not only competitive content but better picture and sound quality (and other features such as closed captioning). DVDs are a strong driver of digital services and equipment take-up.

Australian sales of DVD films and television programmes have increased 20-fold since 1999 from 1,456, 689 units sold in the 1999-00 financial year to 27,958,026 units sold in the 2002-03 financial year[31].

In addition, 3.6 million DVD players have been sold in Australia, with 1.5 million units sold in the 12 months to March 2004[32].

Digital television sales also support growth in digital open broadcasting, digital subscription broadcasting and DVD viewing. 400,000 widescreen digital television sets have been sold to date in Australia, with 238,000 units sold in the 12 months to March 2004[33].

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[30] Paul McIntyre, Sydney Morning Herald, 8 July 2004, quoting the report "*Total TV Usage*" from OzTAM

[31] Australian Visual Software Distributors Association Limited, Available at http://www.avsda.com.au/stats.htm

[32] Ibid

[33] Ibid

- ***Content acquisition in the television entertainment market – the dominance of commercial and national broadcasters***

The dominant market power of the commercial and national broadcasters over subscription television, and of the commercial broadcasters in particular, can be clearly seen in the ways in which they acquire general entertainment programming, a key area of competition between commercial broadcasters and subscription broadcasters.

In some instances, the terrestrial broadcasters use their market power to buy out subscription television “windows” to popular programming in addition to the “free” rights, which in turn limits the opportunity for subscription television and can lead to programme hoarding by the terrestrial “free” broadcasters to the detriment of competition and consumers.

The existing market power of the terrestrial broadcasters in relation to general entertainment programming acquisition, coupled with the major legislated advantage given to them in relation to sports programming by way of the sports “anti-siphoning” regime, must be considered and addressed in any assessment of possible terrestrial multi-channelling.

General entertainment is the largest genre of programming provided by subscription television by number of channels and can be broken up into the following sub-categories:

- drama series;
- comedy series;
- infotainment;
- talk shows;
- reality programs;
- game shows; and
- variety shows.

Content acquisition agreements are struck both at major international programming fairs and through individual direct dealings between programme producers and broadcasters.

The four annual trade fairs at which many content acquisition deals are negotiated with distributors and, in some circumstances, producers and sales agents for individual programs or series are:

- NATPE (which is held in January each year in the USA);
- MIP TV (which is held in France every year in April);
- Los Angeles (which is held each year in May); and
- MIPCom (which is held in France each year in October).

At the trade fairs, the Australian commercial and national broadcasters and, in particular, the Seven, Nine and Ten networks, have significant market power above subscription television providers in bidding for programming.

This is due to their greater spending power which is largely related to their greater market reach (OzTAM ratings show the five national and commercial broadcasters share control of approximately 86% of broadcast television viewing in Australia, while the more than 100 subscription television channels, following the launch of new digital channels, share control of approximately 14% of television viewing[34]).

The dominant market power of the commercial broadcasters is demonstrated in available price guides for programming[35] which show that these broadcasters pay up to 10 times the amount paid by subscription television providers for the same programming.

Rights to broadcast programming are generally sold on both a first-run and second-run/repeat basis. First-run rights mean that the holder of those rights is able to broadcast programming for the first time on television in Australia, and they may also have the right to broadcast one or two repeats of that programming. Second-run rights generally mean that the holder of those rights is able to broadcast repeats of a series which has already been broadcast on television in Australia.

Given the disparity in the amount of money that subscription television, at this stage of its development, generally can afford to offer for programming, compared with the amount that the open broadcasters generally can afford to offer, subscription television often acquires second-run rights for programming in

[34] OzTam Release, 1 July 2004

[35] *World Screen News*, March 2004 at p 234

circumstances where a commercial or public broadcaster acquires first-run rights to the same programming.

There have been occasions where a distributor has been unwilling to sell the first-run rights to subscription television because of the lower penetration rate of subscription television compared with open broadcast television in Australia.

During the course of negotiations, the purchaser of first-run rights is able to negotiate a ‘holdback’, which means that the holder of the second-run rights can only commence broadcasting the series 12 months (or some other often longer negotiated period) after the program has been broadcast by the first-run rights holder. If a commercial open broadcaster acquires the first- run rights, they can dictate the length of time after which subscription television may exercise their second-run rights.

In FOXTEL’s experience, the deals that open broadcasters have with the major content-producing studios affect the rights which the studios can then sell to FOXTEL and the terms on which they can do so. For example, if a commercial broadcaster has an output deal with a particular studio, it may mean that the studio can only sell programming for distribution on subscription television subject to the commercial broadcasters’ review.

In some instances, commercial broadcasters have purchased both the first and second-run rights to programming, particularly in relation to the most popular programming. This is referred to in the industry as “buying-out” the subscription television window. In this way, commercial broadcasters are able to hoard general entertainment programming and block subscription television providers from acquiring the subscription television windows to the most popular programming.

These program acquisition practices clearly indicate the superior market power of the commercial open broadcasters in the acquisition of general entertainment programming for Australia, and the ease with which they have previously and can be expected to continue to simply block subscription television providers from providing general entertainment programming to Australian viewers on a second-run basis.

The market power and practices of the commercial broadcasters, coupled with the unique advantages bestowed on them by the restrictive sports “anti-siphoning” regime, would place subscription television in a perilous state in terms of ability to acquire compelling programming – if terrestrial multi-channelling by the commercial broadcasters is permitted in isolation without a re-balancing of the wider regulatory playing field affecting the television entertainment market.

Enabling multi-channelling by the commercial broadcasters, either on a “free” or “subscription” basis, while they exercise such dominance over the acquisition of sports and general entertainment programming would have a severely deleterious impact on competition, tilting regulatory-conferred advantage even more strongly in favour of one group of market participants.

- ***Legislated protection from competition***

The market power of the Seven, Nine and Ten networks and their regional affiliates is significantly assisted by legislation. As the ACCC has noted, the commercial open broadcasters "are provided a level of protection from competition that is not given to firms in other industries"[36].

Supporting the ACCC’s point, analysts have noted that "the operating margins of Australia's major television companies are among the highest in the world, which reflects the benefits provided by the current regulatory structure of the Australian industry"[37].

During the last reported financial year (2002-2003) the average margin for the Seven, Nine and Ten networks was 24.5%[38]. Notably, in 2001 the average margin for Australian commercial open broadcasters was more than 55% larger than the global average[39].

Through successful lobbying, the incumbent commercial broadcasters delayed the introduction of competition from subscription television in Australia until 1995, much later than its launch in other developed countries, and they continue to enjoy regulatory advantages over existing competitors:

- they have the right to use VHF and UHF spectrum bandwidth on the radiofrequency spectrum for a licence fee that is unrelated to the market value of the bandwidth;

[36] ACCC report on *Emerging market structure in the communications sector*, June 2003, p xvi

[37] ABN Amro, *FTA Television Time to face the Facts*, July, 2002 p 31

[38] Coleman, G *The Consequences of Technological Change*, presentation at ABA – Conference, June 2004

[39] ABN Amro, *FTA Television Time to face the FACTS* July 2002 p 13

- restrictions on the access of subscription television to sports programming through a sports "anti-siphoning" regime that is the most restrictive in the world and guarantees commercial and national broadcasters exclusive first access to the most valuable sports programming;
- a moratorium, set in place in 1998, protects the commercial open broadcasters from new commercial television broadcasting licensees until 2007;
- they have been loaned publicly-owned spectrum, at no charge, to subsidise their transition from analogue to digital formats; and
- regional commercial open broadcasters have been given a rebate of approximately $260 million from their normal licence fees over a 13 year period[40], to further subsidise their conversion to digital.

Importantly, the moratorium on the issuance of a 4th commercial television broadcasting licence between 1998 and 2007 gave investors almost a decade of certainty about the commercial environment in which the commercial open broadcasters were to operate. As a result, any investment risk associated with the construction of the digital terrestrial transmission infrastructure was minimised.

The core regulatory obligation placed on the commercial broadcasters to justify this protection is in the area of local content, where they have been required to broadcast minimum levels of Australian programming.

The entrenched competitive position of the commercial open broadcasters has, similarly, been promoted by regulatory constraints on the ability of subscription television to compete with the commercial open broadcasters:

- advertising was prohibited on subscription television until 1997;
- there is still the requirement that subscription fees be the predominant source of revenue for subscription television channels;
- satellite delivery of subscription television was limited to provision by three licensees on the Government mandated AUSSAT satellite until 1997; and
- subscription television suffers under the sports anti-siphoning regime previously mentioned.

In contrast to the regulatory certainty given to the commercial open broadcasters through the moratorium on new commercial television broadcasting licences,

[40] Department Media Release, *Assistance for Digital Television in Regional Areas,* 9 May 2000, available at http://www.dcita.gov.au/Printer_Friendly/0,,0_1-2_1-4_14980-LIVE_1,00.html

participants in the subscription television sector have been confronted with the possibility of regulatory change and involved in preparing submissions in response to one or more new Government reviews in every year since 1997.

Frontier Economics concludes:

> *"Currently, subscription and free-to-air television providers do not compete on an equal basis. Datacasters' activities are severely constrained. The entry of new free-to-air licensees is constrained. Proceeding to increase 'competition' without addressing these fundamental problems runs the risk of entrenching the position of incumbent free-to-air players not because they offer better services to the public, but because they enjoy uncosted benefits conferred by Government"*

3.3 Subscription television's contribution to competition in the market

Although subscription television has not yet reached a viable scale, its participation in the television entertainment market has delivered significant benefits to Australians since its introduction in 1995:

- more than 5,000 people are directly employed by the subscription television sector;
- FOXTEL currently employs more than 1,800 people directly, with a further 1400 who are directly engaged in external sales and installation activities; by the end of 2005 FOXTEL projects it will employ over 2,000 people in the areas of television creation, packaging, technology, promotion, marketing, sales, business and customer service;
- 50 different media and communication companies share ownership of the channels carried by FOXTEL Digital; 20 of these are Australian owned or Australian based;
- there are 7 independent news and information channels available through FOXTEL Digital:
    - BBC World;
    - Bloomberg;
    - CNBC;
    - CNN;
    - Fox News;
    - Sky News Australia, (including interactive applications and the Parliamentary Channel and the Election Channel);
    - the Weather Channel.

Plus SBS World News is made available by way of retransmission.

In overview, the channels on FOXTEL Digital owned by the 50 different media and communication companies include: 10 movie services (including the interactive FOXTEL Box Office service); 7 sports channels; 5 childrens' channels; 6 music video channels and 30 audio music channels; 11 documentary channels; 8 lifestyle channels; 14 general entertainment channels; 2 non-English language channels (Italian and Greek); and 2 interactive games channels.

A comprehensive list of the numerous owners of subscription television services carried on FOXTEL is set out in schedule 2.

In addition, subscription television enhances competition and promotes the policy objective of increased competition and diversity in Australian media through undertakings given by FOXTEL, primarily, and other companies involved in subscription television, in connection with the FOXTEL-Optus Content Supply Agreement in 2002.

The pro-competition undertakings by FOXTEL are the most comprehensive ever given to the ACCC by any enterprise in Australian industry.

The effect of the CSA arrangements was to provide a level of stability in subscription television, and the prospect of economic sustainability for the sector, which was then capable of attracting third party investment needed to build subscription television's digital infrastructure.

However, as the ACCC confirmed when it approved the CSA in November 2002, the CSA did not give FOXTEL a competitive advantage over other subscription television operators, the commercial broadcasters or possible new market entrants.

Neither did the CSA change the balance of power in the television entertainment market. Rather subscription television in Australia was simply unsustainable without it.

The CSA does, however, mean that FOXTEL is operationally regulated to a greater degree than any other broadcaster in Australia and, by virtue of undertakings approved by the ACCC, its business practices and obligations enhance competition, innovation and diversity.

The FOXTEL undertakings were publicly tested and then approved by the ACCC in November 2002. The most significant of them – and the pro-competitive outcomes they provide - are summarised below[41]:

- ***Digital investment undertaking***

  In 2002, FOXTEL undertook to commence a digital service (at a then estimated cost of more than $600 million), subject to relevant legislative and regulatory conditions and the prior approval of the Boards of FOXTEL's shareholders and FOXTEL's Board.

  As referred to previously, FOXTEL Digital was launched in March 2004.

- ***Digital access undertaking***

  FOXTEL has committed to provide access to its digital cable and satellite set top units for independent third party subscription television providers.

  In this way digital open access encourages competition creativity and diversity across the television industry and opens opportunities for local content providers and new entrants. For example, sporting bodies have the opportunity to develop their own subscription television channels if they elect to do so.

- ***Downstream wholesale offer***

  FOXTEL has also committed to offer its channel line-up (subject to rights availability) to downstream wholesale operators who intend to invest in new infrastructure provision. This downstream undertaking extends to ADSL infrastructure operators if FOXTEL commences supplying an ADSL service.

  These undertakings overcome any concerns that infrastructure operators may not be able to source programming on a competitive basis.

[41] Undertaking to the Australian Competition and Consumer Commission by FOXTEL Management Pty Ltd (for and on behalf of the FOXTEL Partnership) and FOXTEL Cable Television Pty Limited, November 2002

- ***Price cap on FOXTEL basic***

  This undertaking included a three-year cap on FOXTEL's basic retail price (based on satellite price and subject only to CPI rises) that expires at the end of 2005.

  The price cap benefits both consumers and downstream wholesale buyers of FOXTEL with a guaranteed basic service price for a three year establishment period. Wholesale buyers of FOXTEL content now have certainty of costs in order to plan their infrastructure investment.

- ***Non-exclusive channels***

  FOXTEL has committed not to acquire any subscription television channels that are currently shared channels with Optus on an exclusive basis, and Optus has made a reciprocal undertaking.

  This undertaking ensures that neither FOXTEL nor Optus can acquire exclusive subscription television rights to Antenna, BBC World, Cartoon Network, CNBC, CNN, Disney, ESPN International, National Geographic, RAI, Sky News, Sky Racing, TCM, TVSN and World Movies (collectively, ***Shared Channels***). This enables independent operators to acquire those channels directly rather than through FOXTEL or Optus.

  FOXTEL will also not acquire the Movie Network channels on an exclusive basis nor the PMP Movie Channels on an exclusive basis at the expiry of FOXTEL's current agreement with PMP, unless this is a requirement of the movie channel supplier, or another party has bid for those rights exclusively.

  This will ensure as far as possible that in addition to the Shared Channels, the three Movie Network channels (Movie One, Movie Extra, Movie Greats) will remain available non-exclusively for independent operators to acquire, as will the three PMP Movie channels (Showtime, Showtime 2, Encore) on the expiration of FOXTEL's current agreement with PMP.

- ***Non-affiliated channels***

  FOXTEL will ensure that 30% of the subscription television channels in FOXTEL's basic service will be completely non-affiliated with FOXTEL or its shareholders.

- ***Non-exclusive 3G/Internet/High Speed Broadband rights***

  FOXTEL will not acquire 3G, Internet or high speed broadband rights in partnership with any of its shareholders (nor bid on the condition that such rights be licensed to its shareholders), nor will it license any such rights to any of its shareholders on an exclusive basis. If FOXTEL supplies those rights non-exclusively, it will supply them to all third parties on terms which do not discriminate unfairly between third parties. FOXTEL has also undertaken not to acquire, in certain circumstances, subscription television rights acquired by its shareholders as part of a bundle of 3G, Internet or highspeed broadband rights.

  This undertaking removes any concern that might arise from FOXTEL's ability to acquire 3G/Internet/High Speed Broadband rights.

- ***AFL Channel***

  For so long as FOXTEL has exclusive rights to AFL match coverage or produces an AFL-dedicated channel, it will sub-license that coverage or channel to subscription television providers on terms which do not discriminate unfairly. FOXTEL will also only sub-license AFL coverage or an AFL-dedicated channel from its shareholders if either FOXTEL or the shareholder agrees to sub-licence that coverage or channel to subscription television providers.

- ***Local content***

  It has, in addition, committed to spending a minimum amount on Australian programming produced by independent producers not associated with FOXTEL or its shareholders.

  FOXTEL has committed to maintaining its spending on independent third party production at current levels adjusted for CPI on an independent audited basis.

As previously discussed, the most significant recent development in Australian television is the launch by FOXTEL and Austar of new digital subscription television services in March 2004 with the result that subscription digital television is now available to Australian viewers over cable and satellite in metropolitan areas and by satellite in regional and rural areas.

To date, subscription television operators (primarily FOXTEL in metropolitan areas and Austar in regional areas) have sold over 500,000 digital subscriptions, representing nearly

7% of Australian television households[42]. FOXTEL alone is installing over 15,000 homes each week with digital reception equipment.

Through the FOXTEL Digital service, FOXTEL has become the leading innovator in Australian television, providing from March 2004:

- expanded programming choice with more than 100 channels and services that provide programming covering all genres, including movies, sport, news, general entertainment, music and kids
- the FOXTEL Digital Guide, the most comprehensive electronic program guide on Australian television. The on-screen guide (current day and the next seven days) details all programs and allied synopsis information according to time, genre or channel. It has a memory/reminder function to recall and indicate what viewers have selected in advance to watch (up to seven days in advance)
- FOXTEL Box Office, a 24-hour-day near-video-on-demand service screening a range of blockbuster movie titles each starting every 15-30 minutes
  Sky News Active, an interactive service allowing viewers to control and choose the news they want to view from eight live video and five live text screens
- Sports Active, an interactive sports application which enables viewers to select multiple camera angles and match replays together with game statistics, player profiles and even different audio feeds on special selected sports broadcasts
- FOXTEL Gamesworld, offering subscribers two games channels and 10 different games with easy to play titles and games that are more difficult
- digital quality pictures and CD quality sound on all FOXTEL Digital services
- widescreen and AC3 Surround Sound, FOXTEL Digital includes more than 47 channels broadcasting 16:9 widescreen content and 13 channels with enhanced surround sound

FOXTEL will add to these digital innovations over the next 12 months with:

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

[42] Kim Williams, CEO, FOXTEL, presentation to Australia Israel Chamber of Commerce, 27 May 2004

- programme closed captioning to assist the deaf and hearing impaired

All of these features are only available to digital subscribers and will, as a result, further promote viewer conversion from analogue to digital with genuine service benefits to consumers.

Value for consumers is also being enhanced. For example, the new FOXTEL Digital basic service costs $48.95 per month for 66 channels (36 television channels plus 30 audio channels) including interactive sports (AFL and NRL) and interactive news services – compared with the 25 channels in FOXTEL's basic package for $48.95 per month available through the old, existing satellite service.

Through all of these innovations, subscription television exerts competitive pressure on other digital television providers – open broadcasters and DVD - and benefits Australian audiences by inspiring and driving digital innovation and enhancing competition.

4. The progress of existing market forces on digital television take-up in Australia

Existing market participants, through their digital services, are successfully promoting the voluntary conversion of Australian audiences from analogue to digital at a rate that is increasing rapidly, as described below.

While reforms to the regulation of digital television are now being considered, regulatory change should not occur that may destabilise already substantial investment in digital television to-date, and deter future investment.

Existing market participants, and digital investments, will continue to build new services and drive digital take-up, as long as no further competition imbalances are imposed on the market via the isolated enabling of multi-channelling by the commercial broadcasters.

4.1 Digital television take-up to date

Market information on digital terrestrial open broadcast television, digital subscription television (both cable and satellite) and DVD equipment sales in Australia indicates that, after a slow start in the case of digital terrestrial television in particular, existing market forces are driving conversion to digital television.

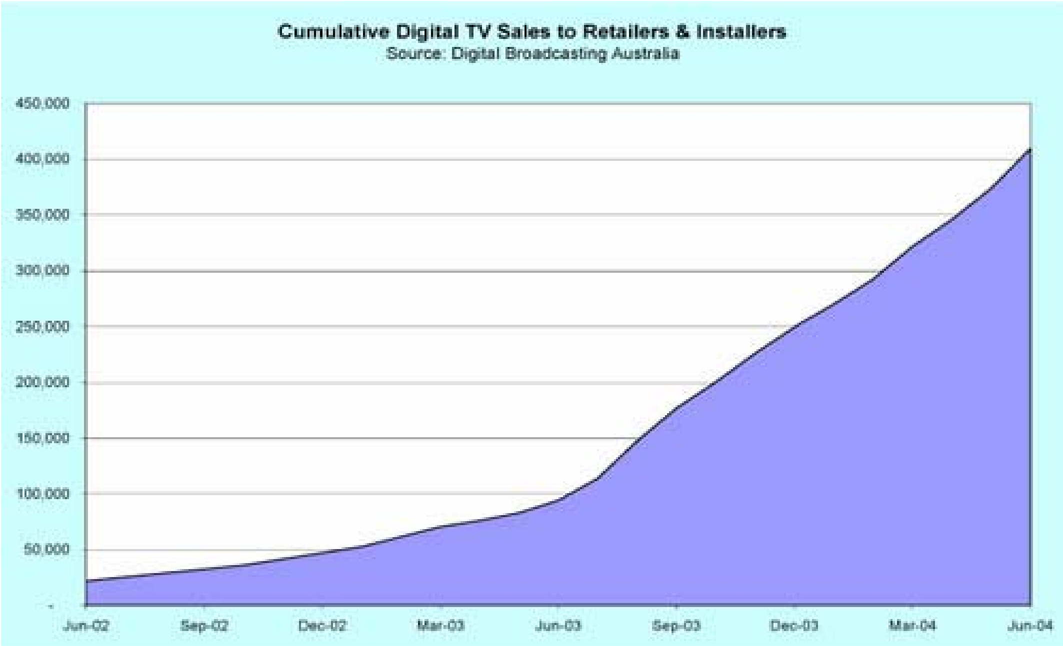
Since their first transmission in metropolitan areas in 2001, the digital terrestrial television broadcasting services of the 5 national and commercial open broadcasters are now available to approximately 80% of the Australian population. As at the end of June 2004, approximately 91% of the population has access to at least one national or commercial broadcasting service in digital mode[43]. Digital terrestrial services in all metropolitan areas include transmissions in HDTV format and there is already HDTV transmission of digital services in some regional areas[44].

Recent data suggests that the take-up of reception equipment capable of receiving digital terrestrial services is now growing strongly after a slow start. As at June 2004 over 350,000 free-to-view digital receivers (either integrated digital television sets or set top boxes) have been sold in Australia, of which 250,000 units were sold in the 12 months to

[43] The Hon Daryl Williams, Opening Address to the Australian Broadcasting Authority Conference, 25 June 2004. Available at http://www.darylwiliams.dcita.gov.au/Article/0,,0_7-2_4011-4_119344,00.html

[44] Ibid

March 2004[45]. Digital Broadcasting Australia (***DBA***) estimates that digital terrestrial receivers are now in approximately 5% of television households in Australia.



Growth in integrated digital television set and terrestrial set top box sales since June 2002 (source DBA)

As described in section 3.3 above, the recent launch of subscription digital television in Australia has also inspired significant digital take-up. FOXTEL launched its subscription digital service in March 2004 and has committed to investing more than $600 million in the full digital upgrade of its cable network and the expansion of its subscription digital satellite service. This investment will see major infrastructure developments such as the FOXTEL Digital Campus in North Ryde, Sydney, a new FOXTEL Customer Services Centre in Moonee Ponds, Melbourne.

Another favourable indicator of digital television take-up can be seen in the increasing take-up of widescreen television sets, digital television sets, DVD sales and rentals and DVD players:

- Australian sales of DVD films and television programmes have increased 20-fold since 1999 from 1,456, 689 units in the 1999-00 financial year to 27,958,026 units in the 2002-03 financial year[46];

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[45] Ian McGarrity, Chairman, Digital Broadcasting Australia (DBA), presentation at the Network Insight Digital Television Reviews Conference, 8 June 2004

[46] Australian Visual Software Distributors Association Limited, Available at http://www.avsda.com.au/stats.htm

- 3.6 million DVD players have been sold in Australia to date, with 1.5 million units sold in the 12 months to March 2004[47]; and
- 400,000 widescreen television sets have been sold to date, with 238,000 units sold in the 12 months to March 2004[48].

These statistics indicate that consumers are recognising the benefits of digital television and investing in the technology and services at a growing rate.

Drivers of digital television take-up include:

- ***Launch of the FOXTEL Digital and Austar Digital services***

  The digital subscription television services launched by FOXTEL and Austar in the first quarter of 2004 have greatly enhanced competition among digital service providers, providing more digital choice to consumers and promoting digital television take up as a result.

  The promotion and launch of new digital television applications by the subscription television sector can be expected to increase viewer interest in digital conversion (see section 3.3 above).

- ***The number and sophistication of digital terrestrial television services is increasing.***

  The launch of national digital subscription television in early 2004 has spurred a competitive response from the open broadcasting sector:

  - In early 2004, the Nine Network commenced using its interactive Sports Active service to provide enhanced programming on its AFL and NRL sports coverage[49].
  - The Seven Network is also using enhanced program elements in its digital coverage of major sporting events, *e.g.* the Rugby World Cup 2003 and the

[47] Ibid

[48] Ibid

[49] Digital Broadcasting Australia, *Nine Sports Active Launched*, 8 March 2004 Available at http://www.dba.org.au/index.asp?display=news&newsID=511

2004 Olympic Games. It will be televising the opening and closing ceremonies of the Olympic Games in high definition television digital format (***HDTV***)[50].

- The *SBS World News* digital service was launched in 2001, together with an SBS electronic program guide, *SBS Essential*. SBS World News is re-transmitted on the FOXTEL Digital service.
- The coordinated digital terrestrial television campaign conducted by the commercial broadcasters in 2003 and 2004 (called *Digital Television: Free To View*) was reported to have had very positive results on the sales of reception equipment following its launch[51]. It included prime time advertisements across the commercial open broadcasting services[52] and these are expected to continue to drive the take-up of digital terrestrial services.

- ***HDTV***

HDTV has emerged as the principal driver of conversion to digital television in the United States. A description of the significance of HDTV to digital television take up in America is set out in schedule 3 and supports the logic that HDTV quota requirements in Australia should be maintained.

All metropolitan commercial broadcasters now meet or exceed their HDTV quota requirement of 1,040 hours per year[53] and a number of Australian produced television drama series are produced in HDTV format (*e.g. Home & Away*, *All Saints* and *McLeod's Daughters*).

The increased availability and declining cost of HDTV programming (particularly from the United States) will give the commercial open broadcasters greater access to HDTV programming and greater opportunity to promote it as a driver of digital television take-up.

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[50] Digital Broadcasting Australia, Free to View Digital Television Information Bulletin [Jun-Jul 2004]. Available at www.dba.org.au/newsletter/IB-JunJul04-full.asp

[51] "CTVA reports positive results for digital TV campaign", B&T, 18 August 2003 Available at http://www.bandt.com.au/news/a6/0c0192a6.asp ; Toby Marshall, "Aussie digital TV advertising leads to increased sales". Digital TV Group, 18 August 2003 Available at http://www.dtg.org.uk/news/world/-aust_dtv_ads.htm

[52] http://www.ctva.com.au/documents/digital_tv_Q&A.pdf

[53] ABA news release NR 37/2004 *Television Broadcasters Meet High Definition Broadcasting Requirements*, 22 April 2004, Available at http://www.aba.gov.au/abanews/news_releases/2004/37nr04.htm

- ***Increased availability of digital television reception equipment and price reductions***

  Technology advances aligned with digital television conversion internationally will promote lower equipment prices in Australia, and therefore assist consumer take-up, accelerated by the international nature of the technology market.

  Currently in Australia, terrestrial digital set top boxes cost from $199 and digital set top boxes that have hard disc storage start from $549[54]. This compares with $699 for a standard definition digital set top box in 2001 when digital terrestrial services commenced[55].

  The rapid take-up of widescreen television sets and DVD players referred to in section 4.1 above, and reductions in the retail prices applying to them, are also driving digital terrestrial and digital subscription services take-up.

  DBA has noted that the price reductions in widescreen television sets:

  > *"[i]s good news for free-to-view digital television in Australia. The advantages of free-to-view television are more apparent on large widescreen televisions and screens. Sales growth of digital television receivers continued at record levels in March and April [2004], mainly on the back of strong sales of widescreen television, DVD and home theatre systems[56]."*

- ***DVD movie recordings***

  Sales of DVD movie recordings continue to grow exponentially (see section 4.1 above). Viewer conversion from analogue to digital will increase as DVD consumers elect to purchase digital television equipment to maximise their DVD viewing experience.

Industry commentators looking at how quickly Australians can be expected to convert from analogue to digital television use as a measure the pace of take-up of new technologies introduced previously. The conclusion is that the take-up of new technologies by Australian consumers follows a cycle and that digital terrestrial television take-up to date in Australia is consistent with that cycle:

[54] Ian McGarrity, Chairman, Digital Broadcasting Australia, presentation at the Network Insight Digital TV Reviews conference, 8 June 2004

[55] ABA update, *Digital TV – One Year On*, December 2001/January 2002 p 16

[56] Digital Broadcasting Australia, Free to View Digital Television Information Bulletin [Jun-Jul 2004]. Available at www.dba.org.au/newsletter/IB-JunJul04-full.asp

“At the original announcement stage, the new product or service (the 'technology') is hyped as a modern marvel. Then the normal years of planning, tooling up and commercialisation work see rumours about delays and problems flourish. Then come the first year or two of introduction when consumers are still discovering the technology. The flat early-adoption curve is usually portrayed as proof that the technology was always doomed. As the technology spreads, thus starting serious take-up, the commentators then rediscover the technology, and provide a new round of positive hype. We seem to be at the beginnings of that stage now [*in relation to digital terrestrial television*] [57]*.*

All of these factors indicate that existing market forces are promoting the conversion of Australian audiences from analogue to digital at a rate that is increasing rapidly. Any reforms to the digital television regime should be weighed against the risk that regulatory change will detrimentally affect these market forces, with the result that the substantial industry investment in digital television to-date may be destabilised and future investment deterred.

[57] Mark Armstrong, "Digital TV: universal one-way broadband?", *Telecommunications Journal of Australia* Volume 53 (4), Summer 2003 at page 3

5. Digital "free" terrestrial multi-channelling by the commercial broadcasters as a possible driver of digital television take-up – issues to consider

5.1 Consequences of introducing "free" terrestrial multi-channelling

If "free" digital terrestrial multi-channelling by the Seven, Nine and Ten networks, and their affiliates, is introduced alone or ahead of other pro-competition broadcasting reforms, the existing competition imbalance in favour of the incumbent commercial networks would be exacerbated. In these circumstances, the market forces currently driving digital television take-up in Australia, particularly in subscription television, would be disrupted and destabilised with a severely negative impact on the television entertainment market and services for consumers.

As a result, commercial incentives to enter the television entertainment market will likely reduce and innovation and investment by subscription television providers, and possible new entrants, will become riskier, limiting the development of product choice and ownership diversity for consumers.

The practical effects of introducing "free" digital terrestrial multi-channelling by the commercial open broadcasters prematurely or in the absence of other reforms are examined in detail below.

5.2 The viability of digital terrestrial multi-channelling

While FOXTEL is not opposed to the introduction of "free" commercial broadcast terrestrial multi-channelling in the manner set out in section 7 below, we note that concerns have been raised about the viability of terrestrial multi-channelling by the commercial broadcasters themselves.

The Nine Network and the Ten Network, and most recently the regional commercial broadcaster Southern Cross Broadcasting in its submission to this review, have made public submissions opposing "free" multi-channelling on the basis that they are unable to find any business model capable of supporting it in the Australian marketplace[58].

[58] Creina Chapman, Director, Regulatory & Corporate Affairs, PBL Media, presentation at the Network Insight Digital TV Reviews Conference, 8 June 2004

In the absence of a commercially viable business model for free-to-view multi-channelling by the commercial open broadcasters in Australia, the Government should consider whether, if the networks are permitted to multi-channel, they will actually proceed to launch "free" multi-channel services. If the commercial broadcasters do start offering "free" multi-channel services, will they be of sufficient quality or sufficiently well promoted to achieve the Government's objective of converting viewers from analogue to digital?

5.3 The UK experience – FREEVIEW and TOP UP TV

FREEVIEW

The Department's issues paper on multi-channelling questions whether the FREEVIEW digital terrestrial television platform launched in the United Kingdom in 2002 after the failure of ITV DIGITAL may be a workable model for Australia.

An assessment of the FREEVIEW model must take into account the significant differences between the UK and Australian markets. The United Kingdom has 25 million households[59] and television is dominated by the taxpayer funded BBC, which together with NHK in Japan is the richest, best-funded broadcaster anywhere.

In Australia there are 7.1 million television households in a market dominated by commercial broadcasters, principally the three commercial television networks, which have primary responsibilities to secure returns to their shareholders.

Any analysis of the FREEVIEW and TOP UP TV business models should also acknowledge that competition in the UK television entertainment market is not unbalanced by the anti-competitive sports broadcasting regulation that applies in Australia

Digital subscription television began in the United Kingdom in 1998, by which time multi-channel subscription television over cable and satellite was profitable. By the time of the FREEVIEW launch, subscription television in the UK had penetration of nearly 40%[60]. In Australia, subscription television was launched only in 1995 and currently has around 24% penetration. Digital subscription television services were only launched in Australia in March 2004 and subscription television operators are not yet cash flow positive.

[59] Department for Culture, Media and Sport, *Moving Forward on Digital Switchover*, March 2004, Available at http://www.digitaltelevision.gov.uk/pdf_documents/publications/44408_DCMSDigital.pdf

[60] OFCOM, *Digital Television Update – Q 1 2004 p5*

The different characteristics of the UK television market are integral to the existence of the FREEVIEW model. The unique market forces and characteristics that enable FREEVIEW (principally the financial and content leadership of the publicly funded BBC) do not exist in Australia.

It is central to the FREEVIEW business plan that it is not intended that FREEVIEW ever operate as a commercial enterprise. Rather, the costs associated with its distribution of the television, radio and interactive services marketed under the FREEVIEW banner are borne by the providers of channels to the platform.

Of the 26 national FREEVIEW television channels, 8 are wholly-owned by the BBC and a further 2 are 50% BBC-owned. The BBC also owns 11 of the 21 radio services and 2 of the 4 interactive services available to FREEVIEW viewers. On this basis, the BBC bears the vast majority of the FREEVIEW platform’s distribution costs.

In the multiplex licence application it lodged with the Independent Television Commission (***ITC***) in the United Kingdom in 2002, the FREEVIEW alliance put great emphasis on a marketing plan that promoted the availability of free-to-view digital terrestrial television on a total platform basis, regardless of multiplex ownership. In addition, the BBC committed to major on-air and off-air promotion of the FREEVIEW service, including a commitment that:

> *In one year, the combined weight of marketing activity would mean on average, every UK adult could be exposed to a minimum of 100 on-air messages from the BBC promoting free-to-view digital television*[61]

In their own words, the members of Digital Television Services Limited (***DTS***) (the cost recovery venture formed to provide marketing and technical services to support the multiplexes used for the FREEVIEW platform) did not launch FREEVIEW in order to profit from their ownership of the platform. The BBC attributed its involvement in FREEVIEW to its "[commitment] to driving digital take-up and to ensuring that as many Licence Fee payers as possible can receive BBC's services"[62].

Crown Castle UK Ltd, the second member of DTS, had built and paid for the digital terrestrial television infrastructure used by ITV DIGITAL before it went into administration in 2002 and separately operated the BBC's own digital transmission infrastructure. Crown Castle's interest in FREEVIEW was to "ensure that all available DTT capacity on the

[61] Application by the BBC and Crown Castle UK Ltd to the independent television commission for Multiplex Service Licences, 13 June 2002, p9

[62] Ibid

network [it owned was] fully utilised"[63]. Having lost ITV DIGITAL as its main customer, Crown Castle's involvement in FREEVIEW was to secure a replacement customer.

British Sky Broadcasting Limited, the final member of DTS, uses FREEVIEW to increase the awareness of the SKY subscription television brand in a wider range of households and increase its advertising revenue in the provision of these television services[64].

From the ITC's perspective, it did not need to be concerned about the commercial viability of the FREEVIEW business model. Not only could it be confident that the Licence Fees paid by the British public to the BBC annually would be sufficient to ensure the future of the FREEVIEW platform but, as part of the FREEVIEW multiplex application, the BBC and Crown Castle undertook to fully underwrite the costs and overheads of the multiplexes they were applying to use for their full licence periods[65].

The BBC estimates that the cost to it of investing in FREEVIEW is now and will remain until the expiration of the FREEVIEW multiplexes (in another 12 years) between 10.7 million pounds (A$27.6 million) and 11.5 million pounds (A$29.7 million) per year[66]. These amounts do not include the cost to the BBC of compiling its digital only services and the digital versions of its analogue services, all of which are broadcast on the FREEVIEW platform.

The FREEVIEW model appears incapable of being adopted by the commercial broadcasters in Australia to promote digital conversion and, without a massive increase in funding, neither of the public broadcasters the ABC nor SBS are in a position to develop a FREEVIEW-like platform from which to promote digital take-up in Australia.

A description of the FREEVIEW business is set out in schedule 3 to this submission and may be useful to the Department when assessing the suitability of the FREEVIEW model for Australia.

TOP UP TV

TOP UP TV is a new digital terrestrial subscription service in the United Kingdom that was launched on 31 March 2004 on the strength of the success of FREEVIEW and effectively

[63] Ibid

[64] National Audit Office report on *The BBC's investment in Freeview* presented to the BBC Governors' Audit Committee 28 May 2004 (the ***NAO Report***) at p 9

[65] Covering letter from the BBC and Crown Castle to the FREEVIEW Application dated 13 June 2002

[66] NAO Report at p 6

piggy-backs on the accelerated take-up of digital terrestrial television driven by the FREEVIEW platform. It is being marketed as a low-cost, low-commitment half-way point between FREEVIEW's free-to-view digital television service and the UK's more established subscription television services (*e.g.* the SKY satellite service and Telewest and NTL cable services)

It is as yet unclear whether TOP UP TV will succeed with its subscription digital terrestrial television where ITV DIGITAL failed; industry commentators have expressed concern as to whether TOP UP TV will work as a viable business model and queried its value for money[67]. Certainly, the “pay-lite” approach to digital terrestrial television which is represented by the TOP UP TV initiative was passed over by the ITC in 2002 when it awarded the abandoned ITV DIGITAL multiplexes to the FREEVIEW consortium ahead of the “pay-lite” proposal put forward by the current owners of TOP UP TV (see schedule 4 at section 1.7).

TOP UP TV offers subscribers a single package of 10 channels for a monthly fee and no annual contract. Although it is broadcast on the digital terrestrial platform and largely depends on FREEVIEW viewers, there is no affiliation between the TOP UP TV and FREEVIEW services. Instead, TOP UP TV shares spectrum with other digital terrestrial service providers (*i.e.* including the ITV broadcasters), and its channels are only available in day parts, as other services transmitted through use of the same digital spectrum end for the day, and transmission capacity for the TOP UP TV services becomes available.

TOP UP TV’s services cannot currently be received through use of the majority of existing FREEVIEW set top units, which do not have smartcard functionality. As low cost equipment capable of offering conditional access becomes more available, however, the market will be better placed to assess whether TOP UP TV’s “pay-lite” product is of sufficient interest to British free-to-view digital terrestrial television viewers to encourage them to pay more for a digital terrestrial set top unit capable of receiving it.

As at May 2004 reported subscribers to TOP UP TV’s service stood at 20,000[68] and TOP UP TV has previously claimed that it needs 250,000 customers to break even[69]. The essential issue to note about TOP UP TV, however, is that this kind of service can only be offered in an environment where there is a strong, mature and multifaceted subscription television sector in place.

[67] Beaumont, Ian *Topping Up DTT*, Available at http://www.transdiffusion.org/bitstream/terrestrial/topping/

[68] Milmo, Dan *TOP UP TV signs up 20,000 viewers* [online], The Guardian 20 May 2004 (available at http://www.guardian.co.uk/business/story/0,3604,1220569,00.html)

[69] Top Up TV press release, *Top Up TV Launches 31 March 2004*, 1 April 2004

A more detailed description of the TOP UP TV service is set out in schedule 4.

Any analysis of the FREEVIEW and TOP UP TV business models should also acknowledge that competition in the UK television entertainment market is not unbalanced by the anti-competitive sports broadcasting regulation that applies in Australia.

In the UK, there is a sports "anti-siphoning" list that covers about a quarter of the number of sporting events covered by the Australian list. Unlike the Australian list, the UK list does not include each and every match played during an event (as is the case with most events on the Australian list), but concentrates instead on only the final rounds of only the most popular events.

As Dawn Airey, managing director of Sky Networks in the UK told the ABA Conference in Canberra in June 2004:

> *"The sparse coverage of Wimbledon on terrestrial TV in [Australia] brings into question the whole matter of anti-siphoning legislation, which unfairly favours one group of broadcasters over another.*
>
> *"In the UK, only the Finals Weekend at Wimbledon is reserved solely for live broadcasting on the free-to-airs. Here the whole tournament is laid at the feet of David Gyngell [Chief Executive of the Nine Network] thanks to the anti-siphoning list. And it's his decision whether or not he offers a few scraps from the table to Fox Sports. That's a total of 600 matches he has in his grasp – including singles, doubles, mixed doubles, seniors and juniors … of which only a limited number are ever going to be seen in their entirety. And, just to rub salt into the wound, not a single volley or ace in this whole sporting extravaganza is being played on Australian soil!*
>
> *"In the UK, the networks have no special privileges that allow them to snaffle up the Australian Open. The French Open isn't a listed event. Neither is the US Open.*
>
> *"As any sportsman or woman will tell you: it's always tricky when the playing field has been tilted unfairly in one particular direction."*

5.4 The US Experience

As in the United Kingdom, market forces driving digital terrestrial television take up in the United States have been determined by the unique characteristics of the US market, which contains more than 100 million television homes compared with approximately 7.1 million homes in Australia.

The Australian digital television regime followed the US regulatory model when commercial open broadcasters were loaned digital spectrum to subsidise their conversion from analogue to digital production and transmission. Broadcasters in the United States were given the same benefit in 1996, and since digital television stations first began operating in the United States in March 1998, all but two of the 40 stations that make up the top-four network affiliates in the top ten television markets in the United States were broadcasting digital terrestrial services[70].

As distinct from Australia, however, as at June 2003, 88.3% of television households in the United States already have access to multi-channel services on a subscription basis[71], mainly through local cable operators that also carry America's open broadcasting services to the majority of their viewers. Multi-channelling is not, therefore, relevant as a driver of digital terrestrial television take-up.

As previously referred to in section 4.2 above, one of the most significant drivers of digital terrestrial conversion the United States is now HDTV and a description of its take up in the US is set out in detail in schedule 3 above.

Critically, the US has no restrictive sports broadcasting regulation. There is no sports “anti-siphoning” regulation in the US, and this in a market where subscription cable and satellite services penetrate more than 88% of homes, compared with 24% penetration of subscription cable and satellite in Australia.

The US experience of a “zero” sports anti-siphoning regime matches the situation in New Zealand where there is also no restrictive sports broadcasting regulation. In both the US and NZ, sports coverage is robust on both “free” and subscription television services, providing further evidence of the extraordinary competitive imbalance imposed in the Australian market against subscription television and in favour of the commercial broadcasters by the Australian sports anti-siphoning regime.

[70] Federal Communications Commission, Tenth Annual Report released January 28, 2004, at p67

[71] Ibid at p 4

To enable “free” commercial broadcast terrestrial multi-channelling while maintaining the existing anti-siphoning system may render subscription television impotent as a competitive force in the Australian market over the long term. Such an outcome would not meet the objectives of the BSA.

6. Digital “subscription” terrestrial multi-channelling – issues to consider

The spectrum loaned to the commercial open broadcasters in 1998 to support their transition from analogue to digital format is a scarce and highly valuable asset. The commercial open broadcasters do not however pay a market rate for the spectrum, unlike subscription television providers which acquire cable and satellite bandwidth at market rates to distribute their services.

Additionally, the bandwidth costs to subscription television providers have increased significantly with the launch of digital due to the increased bandwidth required.

As Frontier Economics notes:

> *“There are several key areas where imbalances in the rules of competition between free-to-air commercial networks and subscription television exist. These include: … the fact that subscription television providers are required to pay for their digital spectrum, but free-to-air networks were not. Moreover, free-to-air networks receive a rebate on their licence fees for deployment of digital television in regional areas. It is true that commercial broadcasters are required to pay licence fees, but these fees are revenue-based and not explicitly linked to the use of spectrum (which encourages spectrum hoarding)”*

Since 2000, radiofrequency licences for metropolitan AM or FM radio services (which use significantly less spectrum than television services) have been auctioned for amounts between $10 million (paid by WIN International for a licence for the Campbelltown licence area, auctioned on 24 May 2000) and $106 million (paid by DMG Radio for a licence for the Sydney licence area, auctioned on 15 April 2004).

Schedule 5 contains a representative list of the amounts received for licences auctioned by the ABA for use for broadcasting services (radio and television) since [1994].

From the Australian taxpayer's perspective, the loan of public spectrum at no charge to the commercial open broadcasters to facilitate their provision of digital television services was made on the basis that they would use it to provide “free” television to all Australians. The subversion of the use of this spectrum for subscription television purposes would mean that:

- the Seven, Nine and Ten networks, and their affiliates, have been given exclusive use at no charge of a public asset for their exclusive private gain without compensating the public for that benefit (where, in other sectors, spectrum is auctioned and the proceeds flow back to the owners); and
- no Australians other than the incumbent commercial broadcasters had been given the opportunity to use this public asset, the loan of which to the commercial television networks would move from temporary to permanent.

As previously referred to in section 1.1 above, the policy basis on which the commercial broadcasters were loaned digital spectrum in 1998 was to ensure the smooth transition of Australian television audiences from analogue "free" television to digital "free" television.

Regulatory reform that allowed the commercial open broadcasters to use this valuable spectrum to subvert and begin transforming the "free" television system into a "pay TV" system for their private gain would be anti-consumer and contrary to the objects of the BSA. Further, it would provide an unfair, anti-competitive commercial advantage to the networks over existing subscription television providers (who must pay for all the cable and satellite spectrum they use).

Subscription multi-channelling by the commercial open broadcasters would lead to a serious imbalance between commercial broadcasting business costs and subscription broadcasting business costs, further advantaging the commercial broadcasters and possibly terminally harming the ability of subscription television to reach profitability and provide sustainable, competitive services. In these circumstances, the commercial open broadcasters would have paid nothing for core digital infrastructure (spectrum) supporting their terrestrial subscription television businesses, compared to the more than $8 billion spent to date by the subscription television industry on infrastructure and other establishment costs[72].

In addition, if the Seven, Nine or Ten networks are permitted to launch digital subscription terrestrial services (using the spectrum allocated to them in 1998 or otherwise) their market power in relation to program acquisitions will increase significantly for the reasons described in section 3.2 of this submission, which concludes:

> *"The general entertainment programming acquisition market power and practices of the commercial networks, coupled with the unique advantages bestowed on them by the restrictive sports "ant-siphoning" regime, would place subscription television in a perilous state in terms of ability to acquire compelling programming – if terrestrial multi-channelling by the commercial broadcasters is permitted without*

[72] FOXTEL media release, 13 November 2002.

re-balancing of the wider regulatory playing field which bounds the television entertainment market.

To the extent that a further increase in the already dominant market power of the Seven, Nine and Ten networks might be legislatively-conferred through subscription terrestrial multi-channelling, it would make it increasingly difficult for others in the television entertainment market to compete.

The failure of any of the providers of digital television services may undermine consumer confidence in digital television as a whole, and the effectiveness of the Government's digital conversion plan generally.

Such an event occurred in the UK in 2002 when ITV DIGITAL, a subscription digital terrestrial television service operated by the equivalent of Australia's commercial networks, went into administration. The UK Government as a result was so concerned about the effects on digital terrestrial take-up that, acting through the BBC, it responded by creating and underwriting ITV DIGITAL's successor, FREEVIEW (described above in section 5.3), to redress what FREEVIEW referred to at the time as a "fundamental failure in public confidence" with the digital terrestrial television platform[73].

On this point, the FREEVIEW business plan filed with the ITC in 2002 following the failure of ITV Digital was based on the premise that "*[digital terrestrial television] is not an ideal platform for pay TV operators; there are too few channels over which to spread the fixed pay TV costs to create a viable alternative to cable or satellite pay television*"[74].

ITV DIGITAL was followed into liquidation by another digital subscription terrestrial television provider QUEIRO TV in Spain which went into administration in 2002.

The ITV DIGITAL and QUEIRO TV experiences should be taken into account when looking at the viability of Australian subscription multi-channelling using the terrestrial television system, and its potential impacts on competition in the television entertainment market.

[73] Covering letter from the BBC and Crown Castle to the FREEVIEW Application dated 13 June 2002

[74] Ibid

7. Regulatory reform to support digital television

7.1 The existing regulatory framework

Australian consumers are benefiting from expanding service choices provided by the existing conversion to digital television. These benefits can only continue to be provided through the promotion of sustainable competition in the television entertainment market.

Further digital service take-up will continue to be driven by market forces already at play in the Australian market.

The FOXTEL Digital and Austar Digital initiatives launched earlier this year, and planned future initiatives by these platforms and related content providers, will remain key drivers of digital take up through their continuing innovation and evolution which will, in turn, exert competitive pressure on other market participants to improve their services.

Subscription television's commitment to digital television to date has been substantial (as mentioned in section 4.1 above, approximately $1 billion) and is likely to continue if there is a fair and competitive market environment.

This large scale of investment requires a stable regulatory environment, at least for a defined period, in order that reliable and sustainable business cases can be developed that can be supported by investors.

This type of regulatory certainty was given to the commercial broadcasters in relation to their digital conversion investments as a matter of Government policy and by way of legislation adopted by the Federal Parliament. As the Department notes in its May 2004 issues paper relating to the multi-channelling review, the moratorium on the issue of additional commercial television licences until 31 December 2006 “recognises that commercial broadcasters will need to spend approximately $1 billion on digital conversion while being required to maintain high quality television services, including local content, during the conversion period”.

FOXTEL, prior to launching its new digital cable and satellite television service, made it publicly clear that its digital investment could only be made if the regulatory environment was stable for at least a defined period. FOXTEL set this out in one of the section 87B undertakings accepted by the ACCC in November 2002 in connection with the CSA. FOXTEL’s commitment to launch a digital service was made conditional in part on:

“the Government not passing legislation which has the effect of allowing broadcasters to multi-channel prior to 2007 or provide [subscription television services] using the terrestrial broadcasting service bands” [75].

Additionally, the Federal Parliament specifically encouraged the digitisation of FOXTEL's service by making changes to the *Trade Practices Act 1974* (***TPA***) in December 2002[76]. These changes to the TPA created the “anticipatory exemption provisions” of Part XIC of the Act which were explicitly introduced to promote efficient investment in new telecommunications services by removing investment uncertainty about the terms for regulated access, prior to the investment being made.

As a consequence of these changes to the TPA, FOXTEL and Telstra each committed to pro-competitive agreements to provide open access to third parties to its digital infrastructure on fair and transparent terms that were subsequently accepted by the ACCC[77].

All of these actions – including the digital investment protection given to the commercial broadcasters and the encouragement of FOXTEL’s digital investment by the Parliament as described above - led the market to have confidence that the Government and the Parliament understood and supported the logic and principle of providing regulatory certainty to support major digital broadcasting investment. Any changes to the broadcasting regulatory environment that are inconsistent with that principle will detrimentally affect the market’s confidence in Government policy-making in the important area of communications infrastructure.

The investment market is particularly sensitive to regulatory changes affecting the television entertainment market because FOXTEL did not rely on its shareholders to finance its digital rollout.

FOXTEL invited new stakeholders into its business and secured $550 million in financing from a banking syndicate led by ABN AMRO and the Commonwealth Bank of Australia, which have since been joined by a range of other banks.

[75] FOXTEL section 87B undertaking, s5.1

[76] Telecommunications Competition Act 2002

[77] ACCC media release, *ACCC accepts Foxtel-Optus pay TV deal,* 13 November 2002

There are a number of covenants that FOXTEL must comply with in relation to the bank borrowings. These covenants include:

- a minimum number of subscribers at various points in time
- a maximum debt to subscriber ratio
- a minimum EBITDA/Debt ratio
- a minimum interest coverage ratio

7.2 FOXTEL's recommendations

"Free" digital terrestrial multi-channelling by the commercial broadcasters

"Free" digital terrestrial multi-channelling by the commercial broadcasters at a defined future date as part of broader broadcasting regulation re-balancing (including the abolition of the sports "anti-siphoning" system) may promote competition in the television entertainment market and, as a result, digital television take-up.

As such, FOXTEL would not oppose regulatory reform that would allow commercial broadcasters to provide "free" digital terrestrial multi-channelling from 2008 - as long as it is considered as part of a comprehensive review and fairer balancing of the television broadcasting regime.

In particular, anti-competitive sports broadcasting regulation through the sports "anti-siphoning" system must be abolished first.

The Government has consistently justified its moratorium on new commercial television broadcasting licences until at least 2007 on the basis that the commercial open broadcasters must first have that time (*i.e.* 6 years measured from the date on which the open broadcasters were required to commence digital transmissions) to establish their digital investments without regulatory change[78].

It is therefore logical and desirable in terms of delivering consumers the benefits of sustainable competition, and in providing investors with reasonable confidence in the Government's adherence to policy fairness, that "free" terrestrial multi-channelling only be introduced after subscription television has had an equitable opportunity (in line with that given to the open broadcasters) to establish its digital investments.

[78] Explanatory Memorandum, Item 1

It is also logical that, in order to achieve optimum outcomes for the Australian community and consumers, the Government first needs to decide whether or not a 4th commercial television broadcasting service should be introduced after expiration of the current moratorium.

Permitting multi-channelling by the commercial open broadcasters is the equivalent of issuing them new commercial television broadcasting licences. While FOXTEL is neither advocating nor opposing the introduction of a 4th commercial open broadcasting service, if Australia is to have a sustainable 4th commercial open broadcasting service, it must be launched and given time to establish before free multi-channelling is allowed by the dominant existing commercial open broadcasters. Otherwise the entrenched dominant players will have first mover advantage over the 4th commercial broadcaster and they will capture available programming and advertising revenue, eliminating any sustainable market opportunity for the new entrant before it has arrived.

The introduction of “free” terrestrial multi-channelling by commercial open broadcasters in any other context and in isolation from other pro-competitive reforms - including the introduction of competitive sports broadcasting through the abolition of the “anti-siphoning” regime as a priority policy action - will harm and constrain competition in the market by further entrenching the dominance of the existing commercial open broadcasters.

The scarcity and high value placed by business on radiofrequency spectrum also supports the conclusion that any decision to allow commercial broadcast terrestrial multi-channelling can only be made after considering the anti-competitive advantages it may confer on the commercial broadcasters over subscription broadcasters – and after the Government has determined whether the same or different parts of the radiofrequency spectrum should be put to use by a 4th commercial broadcaster.

Additionally, FOXTEL’s position is that any legislation permitting “free” commercial broadcast terrestrial multi-channelling should retain and not relax simulcast and HDTV requirements because they are complementary drivers of digital television take-up (see section 4 and schedule 3).

Subscription terrestrial digital multi-channelling by the commercial open broadcasters

The Department’s issues paper seeks views on possible subscription terrestrial multi-channelling by the commercial open broadcasters on the terrestrial spectrum currently loaned to them to provide “free” television services

In essence, the issue is about whether the terrestrial television system, upon which Australia’s “free” television system is constructed, might be expanded into a hybrid “free” and “pay” television system.

To enable subscription terrestrial multi-channelling would clearly be a subversion of the primary purpose for which the commercial broadcasters were loaned publicly-owned spectrum. They were privileged with the loan of that spectrum, and given legislative protection against further commercial network licences, in return for providing “free” digital television to all Australians in metropolitan, regional and rural Australia.

There would be no public benefit in expanding and transforming the terrestrial television system from a “free” television model into a “pay” television model for the exclusive use of the existing commercial broadcasters.

As the representative body of the commercial broadcasters, named “Free TV Australia”, said in a research report released in June 2004: “An overwhelming 85% of the people we surveyed want the quality of Australian Free TV to be maintained and protected. The implication is clear: the current quality and diversity of the Free TV offering is what Australian’s want”.

The only service the commercial broadcasters should be entitled to provide on the terrestrial spectrum loaned to them should be “free” and of the highest standard possible for the benefit of maximum numbers of consumers.

To do otherwise and exclusively enable the existing commercial broadcasters to begin transforming the “free” terrestrial television system into a “pay” television system would gift them with use of a valuable public asset (spectrum) for private gain, to the exclusion of others, and give them an unrivalled competitive advantage. The Government and Parliament, if they took this route, would bestow benefit and anoint winners in a way which was contrary to all principles of equity and fairness in public policy formulation.

In addition, there is a serious risk of negative impacts on the quality of the “free” television system (which Free TV Australia says is so important to most Australians) as the open broadcasters would likely need to allocate resources (financial and programming) to their terrestrial “pay” television businesses to secure its survival. International experience indicates there is a high risk of failure of subscription terrestrial services (see Section 6 of this submission).

In terms of the likely negative impacts on competition, the spectrum gifted to the commercial open broadcasters for their exclusive use at no additional charge beyond their existing licence fees, already gives them a significant cost advantage over subscription television. FOXTEL, for example, pays large amounts annually to Optus and Telstra for the provision of satellite and cable capacity respectively, both for analogue and digital services. These costs have significantly increased with the launch of digital services due to the increased bandwidth required.

There are already low barriers to entry to subscription television where, unlike commercial open broadcasting, there is no limit on the number of subscription television licences that can be issued and where there is ever increasing distribution capacity via diverse satellites and on the Telstra cable network.

Diversity of ownership and content provision is already prolific and expanding in subscription television. Currently, 50 different media and communication companies share ownership of the channels carried by FOXTEL Digital; 20 of these are Australian owned or Australian based;

In addition, FOXTEL and Telstra provide open access to third party content providers to use their digital and analogue subscription television platforms, and the FOXTEL customer base, under access regimes accepted by the ACCC.

By contrast, the commercial broadcasters face no such access requirements and are free to exclude content providers from their terrestrial platforms.

In fact, the majority of the commercial broadcasters are active participants within existing subscription television services, including those carried by FOXTEL. For example, the Seven Network and the Nine Network own equal 33.3% shares in Sky News Australia, the leading Australian subscription television news channel which FOXTEL has supported with advanced digital interactive functions.

In conclusion, the only service the commercial broadcasters should be entitled to provide on the terrestrial spectrum loaned to them should be “free” so that all members of the public can access and benefit from it.

If the Government determines that the terrestrial television system should at a future date be expanded to include subscription services, any spectrum to be used for terrestrial subscription multi-channelling would first need to be identified by the Government after it has made a decision on whether or not spectrum will be allocated to a 4^{th} commercial broadcaster.

If the Government then decides that spectrum should be made available for subscription television services, the allocation of that spectrum should be subject to an allocation process, such as an auction, that gives fair, equal and open opportunity to all potential users without exclusion, in keeping with existing regulatory arrangements for subscription television.

In conclusion, FOXTEL advocates the following:

- **There must be a minimum four year period from March 2004 (the date of commencement of major digital subscription television services in Australia) until March 2008, during which there is no permitted "free" terrestrial multi-channelling by the commercial broadcasters.**

- **The only service the commercial broadcasters should be entitled to provide on the publicly-owned terrestrial spectrum loaned to them should be "free" so that all members of the public can access and benefit from it.**

- **The anti-competitive regulation of sports broadcasting through the "sports anti-siphoning" regime must be abolished - prior to the enabling of any "free" terrestrial multi-channelling by the commercial broadcasters.**

- **Simulcast and HDTV requirements should be retained, as complementary drivers of digital television take-up.**

Schedule 1

Frontier Economics paper

A framework for assessing the provisions of services other than simulcasting by free-to-air broadcasters on digital spectrum

A REPORT PREPARED FOR FOXTEL

August 2004

1. Introduction

The Department of Communications, Information Technology and the Arts is currently conducting a number of reviews in relation to the *Broadcasting Services Act 1992* (BSA). A total of 11 reviews must be completed in 2004 and 2005. The Department has grouped similar issues. This paper, prepared by Frontier Economics at the request of FOXTEL, discusses issues relevant to the Issues Paper released by the Department, *Provision of services other than simulcasting by free-to-air broadcasters on digital spectrum*.

This Issues Paper raises a number of issues and policy alternatives, and seeks views from interested parties. The issues addressed primarily relate to the uses to which spectrum loaned to the free to air broadcasters for the purpose of converting to digital may be put.

There are two important factors to be taken into account in making an assessment of the relative merits of different policy options:

- a set of policy objectives must be identified; and
- the interrelationships between policy measures must be taken into account, so that the performance of any new bundle of regulatory arrangements can be assessed in relation to the Government's policy objectives.

It is a standard first step of policy analysis to develop a framework for policy evaluation. This means that a set of objectives must be identified, and any changes must be assessed on the basis of whether they are likely to improve the attainment of these objectives, or detract from them. (The Issues Paper itself offers no such framework.)

What should be the objectives of policy in the arena of digital television, or broadcasting more generally? Guidance can be taken from the Act itself. We assume that the objects of the Act represent the Government's continuing goals in the area of broadcasting regulation, and it is against these goals that we propose to assess changes suggested by the Department.

It appears that the key tensions in these objectives, and their application in the present review, relate to the desire to improve the state of competition in the industry, without sacrificing other objectives.

In order to make sensible decisions about this trade-off, it is important to recognise that these changes are not occurring in a policy vacuum. Compared with many other industries, the broadcasting industry is subject to a complex web of regulatory arrangements. These arrangements interact with one another. Focussing on a number of micro-issues without reference to the broader regulatory environment is unlikely to lead to sensible policy outcomes.

2. The objectives of the Act

As noted above, we have assumed that the Government's policy objectives in the field of digital television – and broadcasting more generally – are expressed in the objectives of the Act. These objectives (s. 3) are as follows:

(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

(c) to encourage **diversity in control** of the more influential broadcasting services; and

(d) to ensure that **Australians have effective control** of the more influential broadcasting services; and

(e) to promote the role of broadcasting services in developing and reflecting a sense of **Australian identity, character and cultural diversity**; and

(f) to promote the provision of **high quality and innovative programming** by providers of broadcasting services; and

(g) to encourage providers of commercial and community broadcasting services to be responsive to the need for a **fair and accurate coverage of matters of public interest** and for an appropriate coverage of matters of local significance;

(h) to encourage providers of broadcasting services to **respect community standards** in the provision of program material; and

(i) to encourage the provision of **means for addressing complaints** about broadcasting services; and

(j) to ensure that providers of broadcasting services place a high priority on the **protection of children** from exposure to program material which may be harmful to them [emphasis added].

Several of these objectives have no direct relevance to the current inquiry. The most relevant objectives may be summarised as follows:

- the availability of services (a);
- efficiency and competitiveness (b);
- diversity of control (c); and
- high quality/innovative programming (f).

The Act also contains a number of objectives related specifically to the digital television regime (Schedule 4, cl. 6(3)). Compared with the objectives under s. 3 of the Act, the objectives relating to the digital television regime are more operational, and directed at specific regulatory requirements for digital transmission. For example, they relate to issues such as the commencement date for digital transmission, the simulcast period, arrangements for datacasters, limitations on multichannelling, and arrangements for the allocation of spectrum.

3. Key elements of the existing regulatory arrangements

The broadcasting industry is subject to a large number of regulatory restrictions. Any changes to the regulatory regime need to take into account the roles that each element of the regime currently plays. Since all of these elements are closely interrelated, changing one element without considering the 'knock-on' effects on the effectiveness and efficiency of other elements is highly unlikely to lead to optimal policy development.

There are several aspects of the existing policy framework that are relevant to the current review. These include:

- a moratorium on a fourth commercial television licence until at least 1 January 2007;
- the requirement to simulcast analogue and digital television signals for at least eight years, to be reviewed by 2006;
- restrictions on datacasting;
- the requirement for free-to-air commercial broadcasters to provide 1040 hours of high definition television (HDTV) a year;
- the loan of an additional 7MHz of digital spectrum to commercial broadcasters, and the requirement that spectrum currently used by these broadcasters for analogue broadcasts be returned to Government at the end of the simulcast period;
- the prohibition of multichannelling by commercial broadcasters (with limited exceptions); and
- sports programming anti-siphoning and anti-hoarding provisions.

4. A framework for analysis

Digital television allows many more services to be provided using the same amount of spectrum – an improvement in spectrum productivity. It also entails improvements in the quality of television services in terms of picture and sound.

In terms of promoting the objectives of the Act, digital television has the potential to make major improvements in three areas:

- increasing efficiency and competition among broadcasters (objective b);
- increasing diversity of control (objective c); and
- improving quality and innovation in programming (objective f).

The principal policy challenge posed by digital television is how to reap the benefits of potentially greater competition in the broadcasting industry, without sacrificing other policy goals.

In order to assess changes to the existing arrangement, the Government must consider how can digital television's potential to improve efficiency, competitiveness, diversity of control and improved quality and innovation be realised, without detracting from other objectives?

In order to answer this question, the Government must take a broad view of the issues at hand. Focusing on any particular policy question in isolation (for example, the details of the simulcast requirements), without taking into account the implications for broader questions of competition in the industry or previous regulatory commitments risks a failure to meet the objectives of the Act.

4.1 INCREASING COMPETITION AMONG BROADCASTERS

Many of the issues covered in the Department's Issues Paper relate to changes that have the potential to increase competition among existing free-to-air broadcasters, and between free-to-air broadcasters and subscription broadcasters.

In our view, however, improving competition in the industry is a major policy change that needs to be addressed in a holistic manner. Tinkering with the status quo without addressing more deep-seated impediments to true competition is unlikely to maximise the benefits in terms of competition that digital television could offer.

There are three major issues that must be taken into account when assessing how and when competition should be increased in the industry:

- increases in competition need to take into account the policy commitments made by the Government in relation to timing issues. Major investments have been made on the basis of these commitments, which needs to be taken into account;
- competition among broadcasters must be considered broadly. Currently, subscription and free-to-air television providers do not compete on an equal basis. Datacasters' activities are severely constrained. The entry of new free-to-air licensees is constrained. Proceeding to increase 'competition' without addressing these fundamental problems runs the risk of entrenching the position of incumbent free-to-air players not because they offer better services to the public, but because they enjoy uncosted benefits conferred by Government; and

- the risks in terms of allowing the regulatory regime to achieve broader social objectives need to be comprehensively addressed. Existing arrangements in a number of areas are unlikely to be suited to digital television in the longer term. The Government must clarify its objectives in such areas, and design a system that can be compatible with a digital world that entails potentially many channels and many service providers.

These three issues are discussed more fully below.

4.2 INCREASING COMPETITION MUST TAKE ACCOUNT OF EXISTING COMMITMENTS

The conversion to digital by both free-to-air and subscription networks has been undertaken during a (limited) period of protection from new entrants, or the creation of new services by free-to-air incumbents. The three main ways in which competition has been limited during this period are:

- the moratorium on new commercial licences;
- the limitations on datacasting (to be consistent with the moratorium); and
- the existing restrictions on multi-channelling.

On the basis of these limitations, significant investment was made in digital conversion and continues to be undertaken.

As in any industry, some degree of regulatory certainty is required before large and long-lived investments will be undertaken. The lack of certainty associated with regulatory arrangements in the broadcasting industry is striking. As Ms Debra Richards, Executive Director of the Australian Subscription Television and Radio Association (ASTRA) noted recently:

> …I went to our previous submissions: the original ASTRA Submission on Digital Terrestrial Television Broadcasting in 1997; the subsequent submission on the Bill in 1998; the Productivity Commission Inquiry into Broadcasting, remember that, in 1999; submissions on the eight reviews we had to have in 1999 and 2000; submissions on the Bill in 2000; the subsequent submissions and letters to pollies on the phantom Cabinet submissions on the issue of whether commercial television broadcasters would be allowed to multi-channel in 2001, 2002 and 2003. However I think there was a period of regulatory certainty between August and September 2003, but I will have to check as I am a bit hazy on that one.[79]

Such regulatory instability is likely to increase the risks of investment perceived by industry players. This, in turn, raises the return that investors are willing to accept before they undertake new investments. Besides respecting any previous commitments regarding policy timeframes, if any radical changes to existing policy are proposed, they should be implemented in a gradual manner to allow industry time to adjust.

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[79] Richards, D. 2004, Address to the Network Insights Seminar 8 June 2004, Digital TV: The Reviews.

4.3 COMPETITION NEEDS TO BE CONSIDERED BROADLY

The successive waves of microeconomic reform undertaken by both Commonwealth and State Governments over the past two decades have largely been to promote competition and improve the efficiency with which goods and services are produced. These reforms include reductions in import tariffs and quotas across a range of manufacturing and agricultural industries, the dismantling of Government-owned utilities to separate out competitive elements (such as electricity generation and retailing) from monopoly elements (such as transmission); reforming the regulation of a range of professions (such as the medical and legal professions), the introduction of access regimes to a range of monopoly assets, and the separation of policy making, regulatory and service-providing arms of Government.

As the Government considers how to allow competition to develop in the era of digital television, it should recall the key lessons learned during this wider period of pro-competitive reform.

Some of the key principles of pro-competitive reform have been to:

- remove regulatory distortions that influence the ways in which firms are able to compete;
- remove regulatory impediments to competition where the benefits of the restriction do not outweigh the costs or where the benefits can be achieved in other, less restrictive, ways; and
- ensure that access to monopoly infrastructure is available on reasonable terms to access seekers.

The television broadcasting industry operates on a very uneven playing field. Over time, digital television blurs the current distinctions between free-to-air and subscription television. Currently, subscription television offers viewers a choice of many more channels than free-to-air, and seeks to attract consumers with this choice combined with what it hopes to be superior programming offerings. As the full potential of terrestrial digital television is met, then the former difference between subscription and free-to-air television may diminish.

If free-to-air services are permitted to evolve to look more like the current subscription services, it is important that they compete on equal terms. This is not simply a matter of 'fairness'. It relates to the efficiency with which resources are allocated throughout the economy. If one network expands at the expense of another, it should do so because it is able to use scarce resources in a way that increases consumer and producer welfare more successfully than the other network. If it expands simply because it does not pay for all of the resources that it uses, then there is potential for resources to be inappropriately allocated towards this less efficiency enterprise, and consumers may experience a less attractive mix of services as an end result.

There are several key areas where imbalances in the rules of competition between free-to-air commercial networks and subscription television exist. These include:

- the anti-siphoning restrictions need to be reassessed. Sports content is one of the key drivers behind the take-up of subscription television, and also of the popularity of free-to-air services and, as a consequence, their advertising revenues. Control of such content affects patterns of competition between all players in the industry. The longer the list of events on the anti-siphoning list, the more handicapped is the subscription television industry in its efforts to compete against free-to-air networks. If free-to-air networks are permitted to multi-channel beyond the simulcast requirements, then it is even less likely that subscription television networks will gain access to such content – free-to-air networks are perhaps more likely to show all of the listed content on one or more of their additional channels. Therefore, the Government needs to reassess its approach to ensuring that all Australians have access to culturally important sporting content, and redesign the arrangements in a way that minimises the constraints on competition that the regime entails.

- the fact that subscription television providers are required to pay for the means by which they procure the carriage of their digital services, but free-to-air networks were not. Moreover, free-to-air networks receive a rebate on their licence fees for deployment of digital television in regional areas. It is true that commercial broadcasters are required to pay licence fees, but these fees are revenue-based and not explicitly linked to the use of spectrum (which encourages spectrum hoarding). If commercial free-to-air networks are to be permitted to compete more actively against subscription providers, through, for example, multi-channelling (and particularly in the case of subscription multi-channelling), then they should not be permitted to do so on spectrum that was lent to them at no charge by the Government. Some of the regulatory changes mooted in the Department's Issues Paper would give an undue advantage to free-to-air commercial broadcasters that would result in unbalanced competition and hence risks inefficient resource allocation outcomes. It is also likely to entrench existing ownership outcomes, rather than encouraging greater diversity of control among broadcasters. If additional channels, and particularly subscription channels, are to be provided, then this opportunity must be offered to the market as a whole, rather than gifted to the incumbents;

- the limits on the balance between advertising revenue and subscription revenues for subscription television providers need to be reassessed. Currently, subscription television broadcasters are subject to a licence condition that requires that subscription revenues must remain their predominant source of revenue. This limits the way in which subscription and free-to-air networks compete.

5. Conclusions

The digital television reviews to be undertaken by the Department risk making changes to the television broadcasting industry in a piecemeal, uncoordinated fashion with a corresponding risk of serious systematic failure. A framework for analysis must be established, which focuses on the Government's objectives, and employs a coordinated strategy for meeting these objectives. Such a coordinated strategy is only possible if the interrelationships between existing policy measures are taken into account.

The issues raised in the Department's Issues Paper boil down to the following: what should the free-to-air networks be entitled to do with the digital spectrum that was lent to them to convert to digital? The answer to this question depends on the answer to an even more fundamental question: how is competition best encouraged in the television broadcasting industry, without sacrificing other policy objectives?

The principal policy challenge posed by digital television is how the potential to increase competition among service providers – and potentially more diverse ownership arrangements – can be achieved, without sacrificing other objectives?

The broad thrust of pro-competitive microeconomic reform over the past two decades has drawn many lessons on how competition can be fostered. One of the principal lessons from this broader experience is that competition must occur on a level playing field: unnecessary regulatory barriers must be reduced, and uncosted, Government-conferred benefits should be removed. Otherwise, resources are likely to be misallocated throughout the economy, and overall social welfare will be reduced.

In the broadcasting industry, the key issues that must be addressed in this regard relate to payments for spectrum, and access to that spectrum. It would be an odd arrangement to promote 'competition' by giving exclusive, free-of-charge access to spectrum to incumbent free-to-air broadcasters and allowing them to compete more vigorously with subscription television providers, who not only are required to pay for the means by which their digital services are carried but are subject to an access regime. This does nothing to promote the entry of new players into the market, and is likely to further strengthen the market position of incumbents. Before such competition on services is allowed, the basis of that competition needs to be addressed.

Another lesson from this broader experience is that investments are fostered through stable policy environments. Although no regulatory regime can ever be set in stone – governments can always pass new legislation, and new governments cannot truly be bound by previous administrations – previous policy commitments should not be overturned without exceptionally good reasons. Rather than taking a piecemeal approach to reform, a holistic approach must be taken that sets long-term directions for industry. If significant changes to the existing policy framework are to be contemplated, then a clear timetable for change should be established, which allows sufficient time for industry to adjust to the changes. If ad hoc changes to the regulatory regime are introduced that do not take into account the implications for the broader policy framework, this increases the risk that the changes will be unsuitable in the longer term, and will need to be changed. This does not foster a certain and stable investment environment.

In the broadcasting industry, for better or for worse, commitments were made to both free to air and subscription television providers regarding the interrelationships between different elements comprising the existing regulatory regime and timeframes for removing or varying the limitations on certain activities. Significant investments were made on the basis of these commitments. This needs to be taken into account in determining any future policy positions, particularly in relation to the elements that are changed and the timing of those changes.

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Schedule 2

Ownership of services carried on FOXTEL

Channel name	Ownership
ADVENTURE ONE	NGC Network Asia, LLC (100%)
ADULTS ONLY	Main Event Television Pty Ltd (33.3% FOXTEL, 33.3% Austar, 33.3% SingTel Optus)
ADULTS ONLY SELECT	FOXTEL, Australia
ANIMAL PLANET	Discovery Communications Inc. (50%), BBC Worldwide (50%)
ANTENNA	Greek language channel. Distributed in Australia by Overlook BV
ARENA	XYZnetworks Pty Ltd (a 50/50 joint venture between Austar and FOXTEL)
BBC WORLD	BBC Worldwide (100%)
BLOOMBERG TELEVISION	100% owned by interests associated with Michael Bloomberg
BOOMERANG	Turner Broadcasting System Asia Pacific, Inc. (100%)
CARTOON NETWORK	Turner Broadcasting System Asia Pacific, Inc (100%)
CHANNEL V	XYZnetworks Pty Ltd (a 50/50 joint venture between Austar and FOXTEL)
CLUB [V]	XYZnetworks Pty Ltd (a 50/50 joint venture between Austar and FOXTEL)
CNBC	A 50/50 joint venture between Dow Jones (50%), NBC (50%)
CNN	Turner Broadcasting System Asia Pacific, Inc (100%)
COMEDY CHANNEL	FOXTEL, Australia
COUNTRY MUSIC CHANNEL	Austar (100%) (however in the process of being transferred to XYZnetworks Pty Ltd)
DISCOVERY CHANNEL	Discovery Networks (100%) XYZnetworks Pty Ltd have exclusive distribution rights to Discovery Channel in Australia
DISCOVERY HEALTH CHANNEL	Discovery Networks (100%)
DISCOVERY SCIENCE CHANNEL	Discovery Networks (100%)
DISCOVERY TRAVEL AND ADVENTURE CHANNEL	Discovery Networks (100%)
DISNEY CHANNEL	Wholly owned subsidiary of Buena Vista International Inc.
E! ENTERTAINMENT	E! Entertainment Television Inc. (100%)

ESPN	ESPN Inc. (100%)
EUROSPORT NEWS	EUROSPORT Société Anonyme (100%), France.
FASHION TV	F.TV (BVI) Ltd (100%), France.
FOX 8	FOXTEL, Australia
FOXTEL AIR (AUDIO CHANNELS)	Satellite Music Australia (100%)
FOXTEL BOX OFFICE	FOXTEL, Australia
FOX CLASSICS	FOXTEL, Australia
FOX FOOTY CHANNEL	FOXTEL, Australia
FOX NEWS	News Corporation
FOX SPORTS	Premier Media Group (100%) (a 50/50 joint venture between News Limited and PBL)
FOX SPORTS 2	Premier Media Group (100%) (a 50/50 joint venture between News Limited and PBL)
FUEL	Premier Media Group (100%) (a 50/50 joint venture between News Limited and PBL)
HALLMARK CHANNEL	Crown Media International Inc.
HOW TO CHANNEL	Premier Media Group (100%) (a 50/50 joint venture between News Limited and PBL)
LIFESTYLE CHANNEL	XYZnetworks Pty Ltd (a 50/50 joint venture between Austar and FOXTEL)
LIFESTYLE FOOD	XYZnetworks Pty Ltd (a 50/50 joint venture between Austar and FOXTEL)
MAIN EVENT	Main Event Television Pty Ltd (a Joint Venture between SingTel Optus 33.3%, Austar 33.3%, and FOXTEL 33.3%)
MINDGAMES (GAMES)	Games provided by Two Way TV Australia
MOVIE EXTRA	Warner Bros (25%); MGM (25%); Disney (25%); Village Roadshow (25%)
MOVIE GREATS	Warner Bros (25%); MGM (25%); Disney (25%); Village Roadshow (25%)
MOVIE ONE	Warner Bros (25%); MGM (25%); Disney (25%); Village Roadshow (25%)
MTV	Owned by Optus under licence from MTV Networks USA
MUSIC MAX	XYZnetworks Pty Ltd (a 50/50 joint venture between Austar and FOXTEL)
NATIONAL GEOGRAPHIC	National Geographic Channel Australia Pty Ltd (100%)
NICK JNR	XYZnetworks Pty Ltd (50%), Nickelodeon Australia Inc.(50%)
NICKELODEON	XYZnetworks Pty Ltd (50%), Nickelodeon Australia Inc.(50%)
OVATION	Singtel Optus (100%)
RAI	RAI Italy. Distributed in Australia by Overlook BV
SHOWTIME	Sony (20%), Universal (20%), Paramount (20%), 20th Century Fox (20%), Liberty Media (20%)

SHOWTIME GREATS	Sony (20%), Universal (20%), Paramount (20%), 20th Century Fox (20%), Liberty Media (20%)
SKY NEWS	Seven Network (33.3%), Nine Network (33.3%), BSkyB (33.3%)
SKY RACING	TABCorp Ltd (100%)
TCM	Turner Broadcasting System Asia Pacific, Inc (100%)
TECH TV	Comcast Corporation (100%)
THE ARCADE (GAMES)	Games provided by Visionik AS and Taito Corp.
THE BIOGRAPHY CHANNEL	FOXTEL, Australia
THE HISTORY CHANNEL	FOXTEL, Australia
TV1	Sony (33.3%), Universal (33.3%), Paramount (33.3%)
TVSN	TVSN. ASX listed.
UKTV	FOXTEL (60%), BBC Worldwide Television (20%), Fremantle Australia (20%)
VH1	MTV Networks (100%)
W	FOXTEL, Australia
WEATHER CHANNEL	XYZnetworks Pty Ltd (a 50/50 joint venture between Austar and FOXTEL)
WORLD MOVIES	SBS (40%), Australian Radio Network Pty Ltd (30%), Australian Capital Equity (30%)

Schedule 3

HDTV as a driver of digital take up in the United States

Importance of HDTV to digital take-up; the US experience

An indication of the importance of HDTV as a driver of digital television take-up can be seen in the United States, on whose regulatory model the Australian digital terrestrial television regime is based. Under the American digital television regime, commercial broadcasters were given 6MH$_z$ of additional spectrum in which to provide digital services. No restriction was put on the programming to be provided by the commercial broadcasters in the digital transmissions provided that they meet a minimum requirement to broadcast digital programmes. While HDTV was a significant factor in determining the amount of spectrum to be given to broadcasters to support their digital transmissions, the US digital regime differed from its Australian equivalent and did not impose minimum HDTV transmission quotas.

In 2004, the digital television industry focus in the US is on HDTV as the driver of conversion to digital television – not multi-channelling[80]. One of the main objectives of the Federal Communications Commission (***FCC***) in its management of the conversion from analogue to digital open broadcasting in the United States is to maintain and encourage consumer access to HDTV[81]. This objective supports the FCC's belief that "the wide availability of digital programming, and particularly high definition programming, will help speed the transition to [digital television]"[82].

The emergence of HDTV as a cornerstone to digital conversion got off to a slow start and early commentators on digital television in the United States took the view that HDTV was a failure, with few consumers taking it up[83].

At the beginning of 2001, the Wall Street Journal reported that only 60,000 HDTV receivers had been sold[84] since US open broadcasters started transmitting their primary channels in digital format. Factors it cited as relevant to apparent consumer reluctance were lack of HDTV programming, lack of digital television coverage and the high price of equipment.

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[80] M Richer (President Advance Television Systems Committee of the USA), 'Digital Terrestrial Broadcasting in the United States', *Broadcast Technology* no 15, Summer 2003, p 4

[81] K Ferree, FCC Media Bureau chief before the US Senate Committee on Commerce, Science and Transport hearing on Digital TV, June 9 2004

[82] FCC, *Report And Order And Further Notice of Proposed Rule Making*, January 18, 2001, para 11

[83] Australian Subscription Television and Radio Association, *Proof Committee Hansard*, 1 June 2000

[84] J Hart and J Burger, 'Can the FCC Fix the Transition to Digital Television? Stay tuned', *Wall Street Journal*, January 10, 2001.

Nevertheless, at least some of those involved in the US industry remained positive that, with greater support, consumers would come around to HDTV and it appears that this has now happened. In 2001, Philips contended that, in order to promote a more enthusiastic consumer response to HDTV more HDTV programming was urgently needed[85]. In response to comments like these, the FCC urged broadcasters to continue to increase the amount of HDTV programming[86] the broadcast.

Many of the obstacles to the take-up of HDTV in the United States are now falling away. Most television households are now served by stations transmitting digital signals. As at 15 June 2004, 1216 US stations in 207 markets were broadcasting in digital. The National Association of Broadcasters reports that these 1216 stations serve 99.96% of US television households and that 85.75% households are in markets with five or more broadcasters airing digital television.

HDTV content is increasing in the US. In its most recent annual report (released 28 January 2004), the FCC noted that HDTV program distribution has increased across all distribution platforms[87].

Cable operators are currently deploying HDTV nationwide and over 60 million households are passed by a cable network offering HDTV-specific services[88]. Many cable networks are producing significant amounts of HDTV programming, including HBO (which provides 70% of its programming in HDTV format) and FOX Sports Net which produces coverage of over 150 games in HDTV format[89].

The free-to-air networks in the United States are, similarly, increasing their HDTV production and distribution. As of late February 2004, CBS was reportedly broadcasting 27 hours a week of its usual programming in HDTV, while NBC was broadcasting 21 hours and ABC 13 hours[90]. In particular, NBC broadcasts two-thirds of its prime time schedule in HDTV format, including its marquee programs such as *The Tonight Show with Jay Leno*[91].

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[85] FCC, *Report And Order And Further Notice Of Proposed Rule Making*, January 18, 2001, para 11

[86] Ibid para 11

[87] FCC, *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, 10th Annual Report, adopted 5 January 2004 and released 28 January 2004

[88] Ibid p 35

[89] Ibid p 36

[90] Consumer Electronics Association, *Washington Insider Series: The HDTV Transition*, April 2004.

[91] Ibid p 67

Finally, satellite subscription television operators are all offering HDTV format services, including Echostar which offers 50 HDTV channels and Voom which offers 39 HDTV channels[92].

The cost of HDTV reception equipment is also falling in the US. The retail price of HDTV monitors and equipment is said to be dropping at a rate of around 2% per month and digital television sets are now available for under US$1,000[93].

The president of the US Consumer Electronics Association (***CEA***) has said that "[t]wo or three years ago, people were calling HDTV a failure… [today] I have very little worries"[94]. Sales figures support the proposition that consumers are converting to HDTV. As at April 2004, 9 million US households had purchased digital televisions products, and HDTV sets and monitors represented the majority of sales of all televisions with screen sizes measuring 40 inches or more[95]. CEA reports that sales of HDTV television sets increased dramatically in 2003, reaching 4.1 million units, and projects that 5.7 million digital television sets will be sold in 2004, 9.4 million in 2005, 15.6 million in 2006 and 23 million in 2007. Approximately 85% of these sales are projected to be of HDTV sets. HDTV is now recognised as a weapon in the competitive war between cable and satellite[96], indicating that HDTV is now seen as a motivator for consumers.

The FCC continues to see HDTV as an important factor in the transition from analogue to digital was confirmed as early as June 2004 when the chief of the FCC's Media Bureau testified before the US Senate Committee on Commerce, Science and Transportation that consumers now have access to a growing level of compelling digital content, particularly HDTV and recommended that access to HDTV should be maintained and encouraged[97].

The Australian Government should take note of the growth and increased significance of HDTV in the United States and other digital television markets when considering any change to the HDTV requirement.

[92] Ibid pp 45, 54

[93] Consumer Electronics Association, *Washington Insider Series: The HDTV Transition*, April 2004.

[94] Ibid

[95] Ibid

[96] J Ford, President of New Media for Discovery Networks, quoted in M Snider, 'A Defining Moment for TV', *USA Today*, 1 June 2003

[97] US Senate Committee on Commerce, Science and Transportation hearing on Digital TV, 9 June 2004

Schedule 4

The UK Experience – FREEVIEW and TOP UP TV

1. Background

1.1 UK regulation of digital terrestrial television broadcasting

The regulation of digital terrestrial television (***DTT***) in the United Kingdom is contained in the *Broadcasting Services Act* 1996 (the ***1996 Act***). The DTT regime was originally supervised by the Independent Television Commission (***ITC***), which merged into a new Office of Communications (***OFCOM)*** in 2003.

The 1996 Act draws a distinction between licences required to broadcast two or more digital services (a ***Multiplex Licence***) and licences required to provide television services for broadcast in digital form (***Digital Program Licences***).

Under the 1996 Act, the independent analog broadcasters (any Channel 3 (ITV) service, Channel 4 and Channel 5) do not require Digital Program Licences to provide their services for digital broadcast, so long as the timing and content of their digital services are identical to their analog services.

1.2 Digital Program Licences – general

A Digital Program Licence permits its holder to provide television programming for broadcast in digital form.

The only prerequisite to the grant of a Digital Program License is that OFCOM is satisfied that the applicant is a 'fit and proper person', and is not disqualified from holding a licence under cross-media ownership restrictions under the *Broadcasting Act* 1990.

Digital Program Licences continue in force without time limit until the licence is either surrendered by the licensee or revoked by OFCOM for breach of licence conditions.

Both an initial application fee (of £1575) and recurring annual fees are payable. Annual fees are calculated according to an OFCOM schedule as a percentage of revenue (receipts from advertising, subscriptions etc.). The maximum annual fee is £3.5 million (for a licensee with revenue over £400 million)[98].

1.3 Local content requirements

Unless OFCOM agrees otherwise, a Digital Program Licence holder must ensure that a majority of transmission hours (excluding sport, news, advertising and home shopping) is allocated to programs of European origin.

Analog television broadcasts in the UK are subject to certain regional content requirements under the Communications Act 2003 and, in the case of the BBC, an agreement between it

[98] OFCOM, *Digital Television Program Service (DTPS) Guidance Notes and Application Form*

and the Government. The independent analogue services must include a specific proportion of programs produced outside the M25 region in London.[99] Each service must also produce a set amount of original programming[100], and a set amount of programming from independent producers[101]. The requirements for each service are set out in the individual licences. The local content requirements for the BBC are determined by the BBC Board of Governors[102].

1.4 Multiplex licences - general

Available digital television spectrum in the UK has been divided into six multiplexes; 1, 2, A, B, C and D. Each multiplex is capable of carrying between four and six video channels.

Multiplex licences last for an initial period of 12 years and are renewable for a further 12 years.

Under the 1996 Act, multiplex licensees may be required to pay a fee on the grant of their licence together with an additional annual fee (calculated as a percentage of the total multiplex revenue). However, no fees have been payable on the grant of multiplex licences issued to date and the UK Government has determined that percentage licence fees will not be payable under multiplex licences for the first 12 years of any such licence[103].

1.5 Multiplex licences for analog broadcasters

Under the DTT regime, terrestrial broadcasters were offered half a multiplex each (9 Mbits/sec) with which to simulcast digital signals identical to their analog signals. They were free to use spare capacity to develop extra channels, widescreen television services or pay-TV services. A total of three of the six UK Multiplexes are used for these purposes.

Multiplex 1 was allocated to the BBC directly by the Government and is not licensed by OFCOM. Multiplex 2 was allocated to Digital 3 and 4 Limited, a company owned jointly by ITV and Channel 4. As a condition of the licence, part of the capacity on Multiplex 2 is reserved for analogue broadcasters (specifically Channel 3, Channel 4 and the Public Teletext Service) to broadcast their service in digital form[104].

Multiplex A was granted to SDN Limited, a company owned jointly by NTL, S4C and United News and Media. As a condition of the licence, part of the capacity is reserved for services provided by Channel 5, S4C in Wales and Gaelic programming in Scotland.

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[99] Requirements: Channel 4 30%; Channel 5 10%; ITV 50%

[100] Requirements: Channel 4 25%; Channel 5 52% (42% in peak); ITV 50%

[101] Requirements: Channel 4 25%; Channel 5 25%; ITV 25%

[102] BBC Statements of Program Policy 2004/2005 [Online] (Available http://www.bbc.co.uk/info/statements2004/docs/commitments.htm)

[103] Department of National Heritage, Press Release 251/95, 15 December 1995

[104] *Independent Analogue Broadcasters (Reservation of Digital Capacity) Order 1996*

1.6 Multiplex licences to be used for new DTT services – ON DIGITAL and ITV DIGITAL

Multiplex licences for the remaining three multiplexes known as B, C and D were awarded by the ITC on 19 December 1997 to British Digital Broadcasting, a joint venture between the independent broadcasters Carlton and Granada, to provide DTT pay television services.

ON DIGITAL was launched by British Digital Broadcasting on 15 November 1998, using each of its multiplexes to support 6 pay television channels. It was relaunched as ITV DIGITAL in April 2001 but was plagued by technical difficulties and never reached viability. With low profit margins, ITV DIGITAL was forced to rely on its backers, Carlton and Granada, who by September 2001 had invested more than £800 million into the company.

ITV DIGITAL went into administration on 27 March 2002, incapable of paying rights fees of £315 million to the Football League for the right to broadcast lower division nationwide games. Unlike the Premier League matches broadcast on BSkyB, the lower division games failed to attract substantial audiences.

By May 2002 ITV DIGITAL had lost almost a quarter of its viewers and on 24 May 2002 its screens went dark.

Commentators have attributed several factors contributed to the downfall of ITV DIGITAL. The service suffered from low picture quality in many parts of the UK and viewers encountered frequent technical problems. The subscription cards needed to receive the service were simple to duplicate and ON DIGITAL and ITV DIGITAL lost significant revenue through piracy[105]. Further, low subscription rates and the fact that ITV DIGITAL's audience was fragmented between its many niche channels led to low advertising revenues for the service.

In slightly more that 4 years, ITV DIGITAL shareholders had lost £1.2 billion (A$3 billion) on the ON DIGITAL/ITV DIGITAL pay television digital service.

1.7 Re-issuance of the ITV DIGITAL multiplex licences

In May 2002, the ITC issued a notice calling for applications for the Multiplex Licences handed back by ITV DIGITAL. The closing date for submissions was 13 June 2002.

Under the 1996 Act the ITC was required to look at whether "*the award would be calculated to promote the development of digital television broadcasting in the UK other than by satellite"* in determining whether and to whom to award licences. Specifically in determining who was to be given a licence to use digital spectrum, the ITC was required to look at:

- the applicant’s timetable for the commencement of broadcasting the licensed service;

[105] Neligan, Miles 'Analysis: ITV Digital's Troubles', *BBC News,* Wednesday, 27 March 2002 [Online] (Available at http://news.bbc.co.uk/1/hi/business/1680953.stm)

- the proposals for implementing and improving coverage, including the timetable to which the applicant would work;
- the proposals for promoting receiver take-up;
- the applicant's ability to establish and maintain the proposed service throughout the licence period;
- the capacity of the program services proposed to appeal to a variety of tastes and interests; and
- the extent to which the applicant's conduct in contracting for program and additional services has been calculated to ensure and effect competition in the provision of such services,

all in the context of the ITC's wider responsibilities and having regard to, among other things, fair and effective competition.

By 13 June 2002, the ITC had received 6 applications for the Multiplex Licences B, C and D, which it summarised as follows:

Applicant(s)	Muxes applied for	Lead Sponsors/Partners	Description
Digital Television Broadcasting Limited (DTB)	B, C, D	Apax Partners	Platform operator model
Digital Terrestrial Alliance (DTA)	B, C	ITV, Channel 4	Application linked with Freeview Plus
Freeview Plus	D	David Chance, Ian West	Pay-lite proposition106
SDN	B, C, D	SDN	Platform operator model
Crown Castle	C, D	Crown Castle	Application linked with Free-To-View Ltd
Free To View Limited	B	BBC	Free-to-air proposition

2. The FREEVIEW proposal[107]

2.1 Structure of FREEVIEW

FREEVIEW is an alliance between the BBC and Crown Castle UK Ltd. The FREEVIEW platform is supported by a separate service company owned by the BBC, Crown Castle

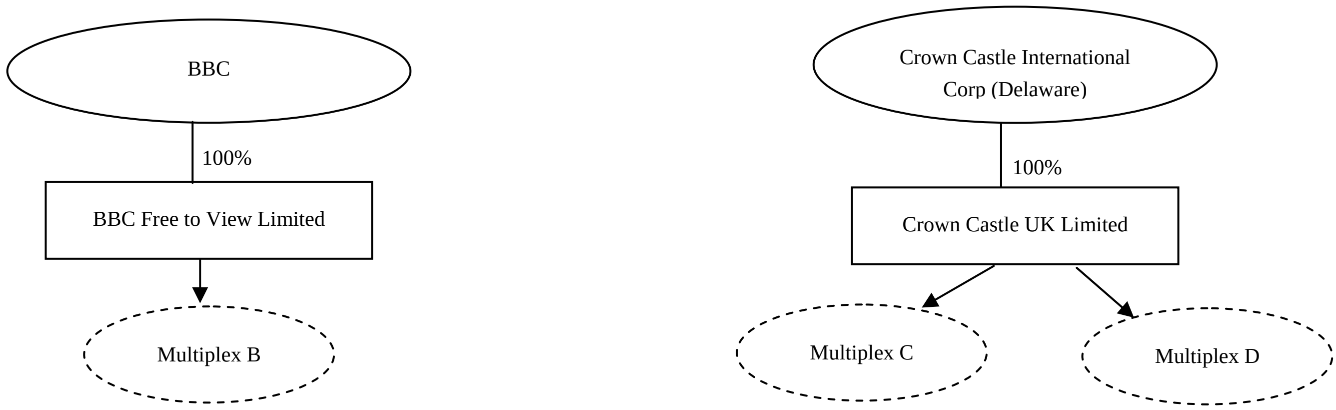
[106] This appears to have turned into Top Up TV, launched in March 2004

[107] per its Multiplex Licence application dated 13 June 2002

and BSkyB, which provides marketing and technical services but in no way controls access to the DTT platform or acts as a gateway.

The structure of the FREEVIEW alliance, of how the BBC and Crown Castle hold and operate the B, C and D multiplexes and of what channels are currently broadcast on what FREEVIEW multiplexes is as follows:

FREEVIEW MULTIPLEX LICENCE HOLDERS



Multiplex B:

- BBC Four (8hrs /day)
- CBeebies (13hrs/day)
- BBC Parliament (24hrs/day)
- The Community Channel (3hrs/day)
- BBCi (videostreams)
- BBCi Digital Text (24hrs/day)
- BBC 1Xtra (24hrs/day) (radio)
- BBC Radio 5 Live (24hrs/day) (radio)
- BBC Radio 5 Live Sports Extra (24hrs/day) (radio)
- BBC Asian Network (24hrs/day) (radio)
- BBC 6 music (24hrs/day) (radio)
- BBC 7 (24hrs/day) (radio)

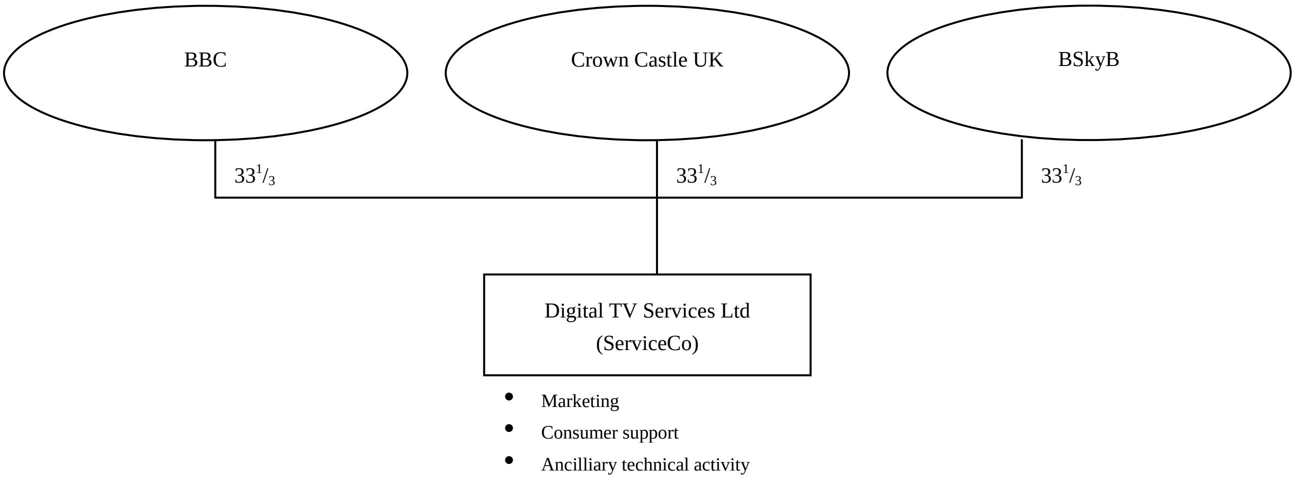
Multiplex C:

- Sky News (24hrs/day
- Sky Sports News (24hrs/day)
- Sky Travel (18hrs/day)
- UKTV History (17hrs/day)

Multiplex D:

- The Hits! (24hrs/day)
- UKTV Bright Ideas (12hrs/day)
- ftn (10hrs/day)
- Ideal World (24hrs/day)
- The Music Factory (24hrs/day)
- Ideal World (24hrs/day)
- YooPlay (24hrs/day) (data)
- 4TV interactive services
- BBC World Service (24 hrs/day) (radio)
- Commercial radio channels

SERVICECO OWNERSHIP



2.2 FREEVIEW objectives

In 2002, the FREEVIEW business plan was based on the premise that "*DTT is not an ideal platform for pay TV operators; there are too few channels over which to spread the fixed pay TV costs to create a viable alternative to cable or satellite pay television*"[108].

It took the view that pay TV on a DTT platform might, however, be possible in the future, particularly with an increase in DTT capacity when digital switchover has been achieved.

The business model focused on achieving the following objectives:

(a) Building a reliable and robust digital terrestrial television (DTT) platform

- 80 transmission stations (as existed for ITV DIGITAL);
- significant technical upgrade, including reducing the number of channels broadcast per multiplex from 6 to 4, to achieve:
    - an increase of 50% in the number of UK homes able to receive DTT on a plug and play basis;
    - the proportion of homes able to receive DTT and affected by impulsive interference (blocking, screen freezing etc) reduced from around 50% to around 10%.

(b) A high quality range of programs and additional services

The FREEVIEW platform sought to collect in one place:

- all of the *BBC*'s existing television and radio services
- 3 SKY free-to-view services

[108] *Cover letter to Freeview application for Multiplex Licences dated 13 June 2002*

- a community channel (representing the interests of charities and not-for-profit organisations)
- a new channel, UK History (supplied by UKTV, a joint venture between BBC Worldwide and Flextech (the programming subsidiary of cable operator Telewest) (***UKTV***));
- interactive and text services,
- 2 commercial radio services, to be determined; and
- 3 other television channels, to be determined.

(c) Ensuring a sustainable business model

The economics of the FREEVIEW proposition involved:

- limited outlay by the consumer and no on-going contractual commitment (consumer outlay limited to purchase of free-to-view boxes readily available, then at around £99 and now at around £60 pounds).
- the sharing of the costs associated with distribution of new and existing services among all providers of channels to the platform.

2.3 Uniform marketing of the DTT platform

The FREEVIEW alliance put great emphasis on a marketing plan that promoted the DTT platform and the services available on it as a whole, regardless of multiplex ownership.

The proposed marketing plan had the following characteristics:

- a collaborative approach, based on working with the receiver manufacturers and retailers;
- promotion of digital services through cooperation with other interested parties such as the Digital Network, Digital Television Group, retailers, manufactures etc;
- a promotional campaign involving, at a minimum:
    - major on-air and off-air promotion by the BBC (in 1 year the combined weight of marketing activity would mean on average every UK adult could be exposed to a minimum of 100 on-air messages from the BBC promoting free-to-view digital television)
    - investigating a common kite-mark to be awarded to manufacturers selling set-top boxes which meet a minimum functionality specification;
    - supporting a consumer information advice centre, with postcode coverage information and related advice on any aerial upgrade needed; and
    - briefing manufacturers and retailers on reception and aerial issues.

Marketing was to be coordinated by ServiceCo and target two distinct consumer groups:

- primary target, 15 million analogue homes, which did not yet have digital TV;
- secondary target, 10 million digital homes, which made by DTT to upgrade additional TV sets.

2.4 "ServiceCo"

The BBC, Crown Castle and BSkyB incorporated a company, Digital TV Services Limited, known as "ServiceCo", to provide marketing, consumer report and ancillary technical actively associated with the multiplexes

2.5 FREEVIEW mission statements

In its application, FREEVIEW's stated mission was:

- to restore consumer confidence and develop the DTT platform into a sustainable proposition; "*this is the last chance for DTT*";
- to target the significant number of households which had not yet been attracted to what satellite and cable pay television had to offer them and who were prepared to stay with 4 or 5 analogue channels rather than take-up pay TV; for these consumers the FREEVIEW platform was positioned as a simple upgrade path – one which was a natural development from the analog TV these "digital avoiders" were used to; and
- to offer a true non-pay digital alternative that would help the Government achieve its digital switchover of 2010.

2.6 Benefits for the FREEVIEW consortium members

BBC

The BBC attributed its involvement in FREEVIEW to its "[commitment] to driving digital take-up and to ensuring that as many Licence Fee payers as possible can receive BBC services".

The National Audit Office (***NAO***) recently released its report examining whether the BBC is achieving value for money from its investment in FREEVIEW. For discussion of the NAO's findings, see section 3.3 below.

Crown Castle[109]

In 1998, Crown Castle had entered into multiplex transmission services agreements with the BBC and ITV DIGITAL to build and operate the digital transmission network for multiplexes 1, B, C and D. To protect its investment, it is in Crown Castle's interest to ensure that all available DTT capacity on the network it operates is fully utilised. Crown Castle receives income from leasing out channels on it's multiplexes. It has contracted annual revenues of approximately £27.2 million for the provision of transmission, distribution and multiplexing services related to its multiplex licences with companies including UKTV, Flextech, Viacom, EMAP, MIETV, OneWord and Guardian Media

[109] Note that on 28 June 2004, National Grid Transco PLC announced that it has entered an agreement to acquire Crown Castle UK and merge it with its own wholly owned subsidiary Gridcom. It will initially continue to trade under the Crown Castle name. National Grid Transco PLC, News Release, 28 June 2004.

Group[110]. Crown Castle has also contracted with the BBC to provide transmission services over the BBC's two multiplexes.

BSkyB

Through its investment in FREEVIEW, BSkyB is able to increase awareness of its brand in a wider range of households and increase its advertising revenue.

2.7 Awarding of the multiplex licences to FREEVIEW

The ITC awarded the B, C and D multiplex licences to the FREEVIEW alliance over the other five applicants on the following grounds[111]:

- the opportunity provided for a fresh start for DTT by offering a distinctive new proposition to consumers;
- the consortium's top-level resolve to launching and sustaining a service for the duration of the licence;
- their approach to addressing technical issues required to improve the performance of the platform;
- the ambitious and clearly developed marketing strategy for the whole DTT platform; and
- the combination within the consortium of management strength-in-depth of its members and their ability and commitment to deliver the stated proposition and hence promote digital terrestrial television in UK overall.

The ITC noted favourably the establishment of ServiceCo to market the platform and that participation in the marketing plan would be offered to all other multiplex licence holders (i.e. the independent broadcasters using Multiplexes 2 and A) so that a DTT platform could be marketed as a whole.

It also took into account the capability of the operators (the BBC, Crown Castle and BSkyB) to support the long-term development of the platform.

2.8 Conditions on the FREEVIEW multiplex licences

The ITC imposed the following licence conditions on the FREEVIEW multiplex licences;

- Crown Castle must sub-licence channel supply on multiplexes C and D on fair, reasonable and non-discriminatory terms (should the BBC choose to sub-licence capacity, the same would apply);
- BSkyB may supply the three channels named in the application on Multiplex C but must not manage a multiplex;
- in pursuit of range and diversity, changes in channel line-up needs agreement from the ITC, as well any proposal to introduce pay services;

[110] US Securities and Exchange Commission Form 10-K Report – Crown Castle International Corp. [Online] (Available at http://www.crowncastle.com/investor/10K/Crowncast2003k.pdf)

[111] ITC, *ITC Announces Decision On Digital Terrestrial Television,* news release, 4 July 2002.

- all technical aspects of the transmission roll-out and receiver specification must be handled through The Digital Network – or its successor – to ensure all-industry participation;
- a non-discriminatory requirement for kite marking boxes that will make it clear that technical specifications should not be used to achieve gateway control; and
- listings information which informs the electronic program guide (***EPG***) must conform to open technical standards to enable TV manufacturers to design their own presentation of program listings.

3. FREEVIEW's existing service

3.1 Existing channel line-up

The current FREEVIEW channel line-up is as follows:

Entertainment

BBC THREE
BBC FOUR
ITV2
Sky Travel
UKTV Bright Ideas
UKTV History
Ftn

News and views 24/7

Sky News
Sky Sports News
BBC News 24
BBC Parliament
ITV News Channel
The Community Channel

Shopping

bid-**up**.tv
price-drop.tv
QVC*
Ideal World

Children's channels

CBBC
Cbeebies

Music

TMF
The Hits

Regional TV channels

BBC TWO Digital
Northern Ireland

Interactivity

BBCi
YooPlay

Text services

BBCi text
Teletext

Radio

BBC Radio 1
BBC 1Xtra
BBC Radio 2
BBC Radio 3
BBC Radio 4
BBC Radio Five Live
BBC Five Live Sports Extra
BBC 6 Music
BBC 7

Radio (cont)

BBC Asian Network
BBC World Service (in English)
Kerrang!
Smash! Hits
Kiss
oneword
jazz fm
The Hits
Q
Magic
Heat
Mojo

Plus existing terrestrial channels

BBC ONE
BBC TWO

S4C Digital in Wales (Welsh language broadcaster)	ITV1
S4C2 in Wales	Channel 4
TeleG in Scotland	five
* not available in Wales	S4C (in Wales)

Out of a total of 26 national television channels available on the Freeview platform, the BBC:

- wholly-owns 8 of the channels; and
- owns 50% of a further 2 of the channels (through its 50% interest in UKTV).

Out of a total of 21 radio services available on FREEVIEW, the *BBC* wholly owns 11.

Of the 4 interactive and text services on FREEVIEW, *2* are BBC services.

3.2 FREEVIEW statistics[112]

By 31 March 2004 digital television penetration was estimated to have reached 53% of households in the United Kingdom, up from 50% at 31 December 2003.

A further 4% of households were subscribing to analog cable, bringing the total number of households receiving some form of multi-channel television to almost 57%.

The uptake of digital terrestrial television increased by 18.6% over first quarter 2004.

Set-top boxes have recently reduced in price and several varieties are available for approximately £50, compared with £99 in 2002.

15% of sales of FREEVIEW adaptors purchased over the last two quarters were purchased for use on a second television set by viewers who already have digital (either FREEVIEW or SKY or cable) on their main set.

At June 2003, 74% of FREEVIEW buyers are older than 35 years and 40% are 55 or older[113].

3.3 National Audit Office (NAO) Report: The BBC's investment in FREEVIEW

On 13 July 2004, the NAO review of the BBC's investment in FREEVIEW was laid before Parliament[114]. The report outlines the cost to the BBC of investing in FREEVIEW and investigates the success of the investment.

Cost to the BBC of providing the FREEVIEW service

The BBC estimates that the cost to it of investing in FREEVIEW will be between £10.7 million and £11.5 million per annum for each of the 12 years for which it holds the Multiplex

[112] Statistics from OFCOM, *Digital Television Update* May 2004 [Online] (Available at http://www.ofcom.org.uk/research/industry_market_research/m_i_index/dtv/?a=87101)

[113] BBC Press Release, *BBC Digital channels reach new homes via FREEVIEW - which is set to be the fastest growing new consumer technology,* 9 June 2003 [Online] (Available at http://www.bbc.co.uk/print/pressoffice/pressreleases/stories/2003/06_june/09/freeview_research.shtml)

[114] National Audit Office, *The BBC's investment in FREEVIEW, Review by the Comptroller and Auditor General,* Presented to the BBC Governor's Audit Committee, 28 May 2004

Licences. Most of this cost will be paid to Crown Castle for transmission services. The total projected expenditure is broken down as follows;

	Projected annual cost (£ millions)
Transmission costs (Multiplex B)	7.2 - 8.0[115]
Coding and Multiplexing (Multiplex B)	1.5
Overheads (including marketing)	2.0

However, these figures do not include the BBC's expenditure on transmission over Multiplex 1. Therefore, the BBC's total actual cost of providing digital terrestrial services during 2003/2004 (including transmission on both Multiplex 1 and Multiplex B plus all associated marketing, coding and multiplexing costs) was £29.35 million.

Neither do these calculations include the costs to the BBC of creating the digital television services broadcast on the FREEVIEW platform.

Value for money

The NAO analysed whether the BBC had met it's objectives through its investment in FREEVIEW and made the following broad observations;

- FREEVIEW has successfully managed to secure the future of digital terrestrial television after the failure of ITV Digital;
- FREEVIEW was successfully launched according to its proposed timetable;
- FREEVIEW has been a success in terms of take-up by consumers;
- the FREEVIEW brand is recognised by 75% of the population.

However, the NAO also observed that;

- up to 27% of households still cannot receive FREEVIEW;
- the BBC should be providing clearer information to licence fee payers about why they may be unable to receive FREEVIEW;
- the BBC's campaigns have not been successful in significantly reducing consumer confusion surrounding FREEVIEW.

Overall, the NAO concluded that, in the context of the Government's commitment to digital switchover, the BBC's investment in FREEVIEW has been largely successful.

[115] Note that the BBC agreed to pay Crown Castle up to £800,000 a year for unfilled capacity on one of the multiplexes operated by Crown Castle. To date the BBC has paid Crown Castle close to £300,000 and the capacity is now full.

4. New Developments: TOP UP TV

4.1 Background

On 31 March 2004, TOP UP TV was launched as a "pay-lite" subscription digital terrestrial broadcasting service, targeting FREEVIEW viewers.

Its promoters are David Chance and Ian West, both formerly of BSkyB, who competed with the BBC and Crown Castle for the B, C and D Multiplexes abandoned by ITV DIGITAL

TOP UP TV does not use any of the spectrum on FREEVIEW's multiplexes. Nor is there a marketing tie-in between the FREEVIEW and TOP UP TV services. For example, there is no mention of TOP UP TV on the FREEVIEW website.

Instead, TOP UP TV is carried on Multiplexes 2 and A (i.e.: the only 2 multiplexes that have not been licensed to the BBC or Crown Castle). Due to the limited spectrum on these multiplexes, TOP UP TV comprises a package of time-shared channels across four or five different channel streams[116].

TOP UP TV channels are, as a result, only viewable, for parts of the day, as illustrated in the following table.

TOP UP TV time-sharing schedule[117]

Channel Number	Top Up TV Channel	Hours	Morning							Afternoon						Prime						Late Night				
			5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	0	1	2	3	4
14	E4	16:00 - 03:59																								
17	UKTV Gold	12:00 - 00:50																								
25	Turner Classic Movies	19:00 - 04:59																								
26	UKTV Style	18:00 - 22:59																								
27	Discovery	12:00 - 22:59																								
28	Discovery Home & Leisure	06:00 - 11:59																								
29	UKTV Food	10:00 - 15:59																								
32	Cartoon Network	06:00 - 17:59																								
33	Boomerang	05:00 - 11:59																								
44	Bloomberg	05:00 - 09:59																								
60	Television X	23:00 - 05:00																								

4.2 The TOP UP TV service

TOP UP TV offers a 10 channel package for a monthly fee of £7.99 without an annual contract. An additional adult channel is available for a further £9.99 per month. There is a £20 initial connection charge (currently discounted to £10 if a viewer subscribes over the Internet).

Early commentary on the TOP UP TV services have queried its value for money when compared with other digital subscription television offerings. The monthly subscription fee for TOP UP TV of £7.99 does not compare favourably with:

[116] Beaumont, Ian *Topping Up DTT* [Online] (available at www.transdiffusion.org)

[117] Dark shading indicates times when Top Up TV digital services are on air and available for reception.

- the ON DIGITAL and ITV DIGITAL offering of six channel streams for £7.99 (TOP UP TV only offers a maximum of five channel streams);
- BSkyB's lowest cost package of £13.50 per month, for seven primary channels, 10 digital music channels, 70 radio channels and 103 free-to-view channels (for which no subscription is required) and BSkyB has since announced its proposal to launch a 200 channel free-to-view service before the end of 2004[118];
- Telewest's cable starter package of £13.50 per month, for 30 television channels (and includes £10 worth of cable telephony);
- NTL's (cable) base pack is £18 for 30 television and 30 radio channels (but includes telephone line rental of £9.50).

TOP UP TV is reported to have signed 20,000 subscribers in its first month of operation[119]. The company's break even target is 250,000 customers[120].

As a subscription based service, TOP UP TV requires viewing cards which plug into 'conditional access modules' on DTT boxes. However, most existing DTT STUs do not accommodate viewing cards and, as a result, cannot receive the TOP UP TV services. Currently, the only STUs in the UK that are able to receive TOP UP TV services are the old ITV DIGITAL boxes, of which around 500,000 are still in circulation[121].

New TOP UP TV compatible boxes were expected to become available in July but are likely to be more expensive than the DTT boxes needed to access FREEVIEW services. It is not clear whether TOP UP TV's offering will be of sufficient interest to UK digital terrestrial viewers to cause existing viewers to replace their boxes and new viewers to the buy more expensive DTT receive equipment necessary to receive TOP UP TV services.

5. New Developments: BSkyB's "FREESAT"

On 9 June 2004, BSkyB announced plans for two new initiatives designed to drive take-up of digital satellite services. The first initiative - a free to air satellite service dubbed FREESAT - is to be introduced in late 2004. The second initiative - a package of premium High Definition Television (***HDTV***) format services – is proposed to be launched in 2006.

[118] British Sky Broadcasting Group PLC press release, 9 June 2004

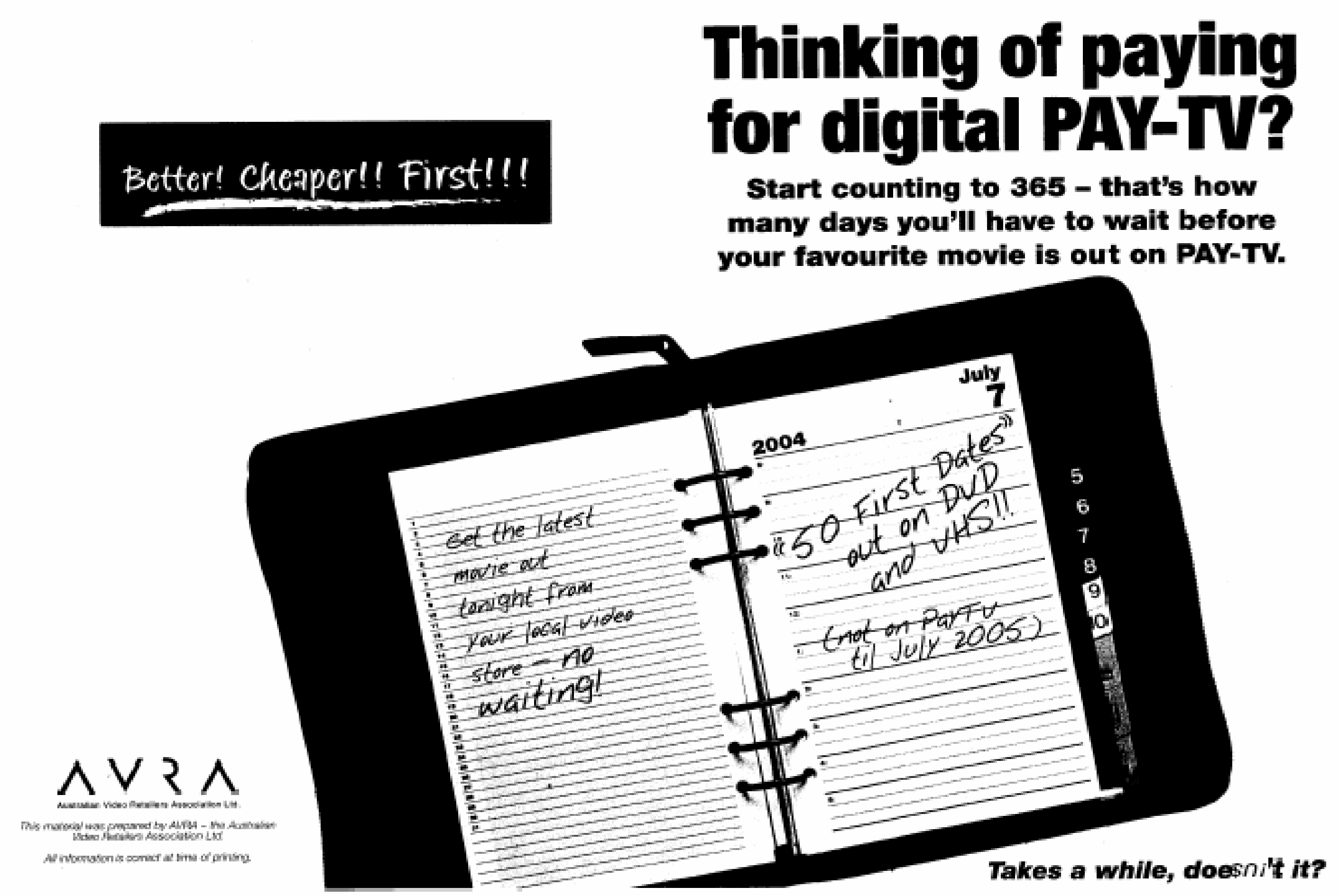
[119] Milmo, Dan 'Top Up TV signs up 20,000 viewers' *The Guardian* 20 May 2004 [Online] (Available at http://www.guardian.co.uk/business/story/0,3604,1220569,00.html)

[120] Top Up TV, *Top Up TV Launches 31 March 2004*, Press Release, 1 April 2004 [Online] (Available at http://www.topuptv.com/press_index.htm)

[121] OFCOM, *Q1 2004 Report on digital television*

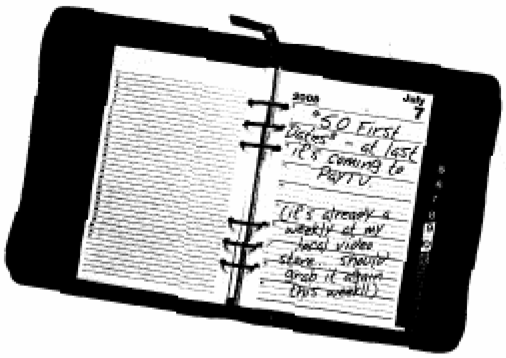
Exhibit A

AVRA Brochure – "Thinking of paying for digital PAY TV?"



GRAB IT ON DVD OR VIDEO

NOW!



Better get used to counting because digital pay television customers will have to wait up to a year longer than video library members to see the same new release movies.

That's a long time to wait at the digital box office for movies like ***50 First Dates***, ***Gothika*** and ***The Secret Window*** – especially when you're paying for the privilege.

Wouldn't it be easier to avoid being locked into the long contracts and expensive commitment? Stop the counting and just head to your local video store.

- **New release movies *at least 6 months* before digital PAY-TV**
- **No $2000-plus contracts, no monthly bill**
- **Thousands more movies to choose from**
- **No schedules – our movies are ready for you, when you want to see them**

Of course, if you enjoy the counting, contracts and costs…

but I'm sure you don't.