



Australian Competition and Consumer Commission

**Submission to the Department of Communications,
Information Technology and the Arts**

in response to

***Provision of services other than simulcasting by
Free-to-air broadcasters on digital spectrum Issues Paper***

23 August 2004

Executive Summary

This submission provides the Australian Competition and Consumer Commission's (ACCC) response to the Department of Communications, Information Technology and the Arts (DoCITA) Issues Paper, *Provision of services other than simulcasting by Free-to-air broadcasters on digital spectrum*.

The ACCC's submission principally addresses the issue of whether the current prohibition on multi-channelling by Free-to-Air (FTA) should be removed by examining the impacts of current restrictions on competition and efficiency in the FTA and pay TV markets.

While this submission examines the issue of the prohibition on multi-channelling, various regulations applying to the FTA TV sector should not be considered in isolation. The relationships between different policies mean that legislative amendments to the current restrictive regime should occur across-the-board, and not be limited to individual changes. This approach recognises that the Government has choices between multi-channelling, HDTV, datacasting and an additional FTA licence as use of limited spectrum.

This submission argues that there are four key benefits to removing the current restriction on multi-channelling by FTA broadcasters.

First, if FTA broadcasters were allowed to multi-channel, the potential for competition both within the FTA sector and between the FTA and pay TV sectors will likely be increased.

Second, the easing of the restrictions on multi-channelling would provide FTA operators with the ability to offer new services to consumers, as well as the potential to provide a wider range of service offerings.

Third, the international experience suggests that increased consumer choice in the form of additional channel offerings provided by digital TV may be a key driver in promoting the take-up of digital services. In this regard, the current restrictions applying to FTA broadcasting, such as the prohibition on multi-channelling, may function to reduce the incentives for the timely adoption of digital TV services. Since there are significant opportunity costs associated with the delay to digital conversion, this will have a negative impact on social welfare. Increasing the potential for competition in FTA broadcasting, as well as between the FTA and pay TV sectors, through the removal of regulatory impediments will likely drive customer choice and innovation, and therefore likely promote the take-up of digital services.

Fourth, the restriction on FTA multi-channelling may potentially undermine the commercial viability of FTA broadcasters over the longer term. Under the current FTA business model, audience fragmentation may lead to the migration of audiences and advertisers to other media, which may, in turn, impact the revenues of broadcasters leading to a deterioration in the quality of FTA programming. The inability to multi-channel restricts the FTA sector from being able to compete with other electronic media to retain its share of a fragmenting audience. Importantly, multi-channelling

provides a means for FTA to cater for the divergent tastes of viewers and respond dynamically to new sources of competition.

In sum, FTA operators should have the choice about whether or not to multi-channel based on the benefits and costs of doing so. Removing the prohibition on multi-channelling is likely to lead to a more competitive and efficient FTA sector, which is better able to meet the needs of Australian audiences.

1 Introduction

The Australian Competition and Consumer Commission (the ACCC) is the independent statutory authority responsible for compliance with, and enforcement of, the *Trade Practices Act 1974* (the TPA). The statutory object of TPA is to enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection.

This submission provides the ACCC's response to the Department of Communications, Information Technology and the Arts (DoCITA) Issues Paper, *Provision of services other than simulcasting by Free-to-air broadcasters on digital spectrum*. The Issues Paper relates to the first in a series of 11 reviews to be conducted before 1 January 2006, pursuant to schedule 4 of the *Broadcasting Services Act 1992* (the BSA).

The first review is intended to examine a number of issues, including whether:

- it is necessary or desirable to continue to require simultaneous transmission of the same version of the FTA service in analogue and SDTV mode for the duration of the simulcast period
- other departures from strict simulcast should be allowed, eg. time shifting or variations between SDTV and HDTV programming, and how content on these services should be regulated
- limitations on digital enhancements should be amended and, if so, under what circumstances and conditions
- limitations on FTA multi-channelling should be relaxed and, if so, under what circumstances and conditions
- the restrictions on use of digital spectrum for other types of broadcasting services (eg. narrowcasting, subscription, radio) should be modified and, if so, under what circumstances and conditions
- there is merit in applying different rules to different types of licence areas or different types of broadcasters.¹

This submission addresses the issue of the impacts of current multi-channelling restrictions, and other regulation, on competition and efficiency in the FTA and pay TV markets.

The ACCC has previously commented on competition in the broadcasting and telecommunications sectors in its 2003 *Emerging markets structures in the*

¹ Department of Communications, Information Technology and the Arts (DoCITA), *Provision of services other than simulcasting by Free-to-air broadcasters on digital spectrum*, Issues paper, May 2004, p. 4.

communications sector report (the EMS report).² This report was in response to a request by the then Minister for Communications, Information Technology and the Arts, Senator Alston, for advice on the extent to which emerging market structures are likely to affect competition across the communications sector.

The ACCC expressed concern about current broadcasting regulation in the EMS report. The Commission's particular focus was regulations restricting further competition between the subscription and FTA television sectors. However, the EMS report commented more generally on the costs and benefits of current broadcasting regulation.

More recently the ACCC has provided comments on the broadcasting regulation in its submission to the Productivity Commission's review of National Competition Policy arrangements.³

The ACCC believes that the costs and benefits of current broadcasting legislation need to be fully analysed and understood, given the importance of broadcast television to the entertainment choice of Australians. It also continues to believe that the onus is on advocates of continued restrictions on competition and restricted supply to demonstrate the benefits of these restrictions outweigh the costs, and that the stated policy objectives can not be achieved without restricting competition.

To assist this assessment, the ACCC commissioned a report by LECG to analyse the potential impact of removing current Government restrictions on multi-channelling by FTA broadcasters on competition and efficiency in the FTA and pay TV markets in Australia. Specifically, LECG was asked to examine the following issues:

- How does the level of FTA and pay TV market concentration in Australia compare with overseas countries?
- What trends are there in consumer preferences? Are viewing tastes becoming more or less homogeneous?
- What developed countries have permitted multi-channelling via terrestrial broadcasting? Which of these countries permit a subscription television model over terrestrial broadcasting?
- What have been the impacts when multi-channelling and subscription television by terrestrial broadcast has been introduced in the overseas jurisdictions?
- What have been the approaches to multi-channelling in different overseas countries? That is, what have been the business case applied to supplying multi-channels, such as whether the multi-channelling have been national or regional

² ACCC, *Emerging markets structures in the communications sector*, A report to Senator Alston the Minister for Communications, Information Technology and the Arts, June 2003.

³ ACCC, *Submission to the Productivity Commission Review of National Competition Policy Arrangements*, 13 July 2004.

signals, how many channels have been re-broadcast, have multi-channels been targeted at particular demographics.

- What are the similarities and differences between the Australia market and the particular overseas markets where multi-channelling has been introduced?
- Is there any guidance from overseas markets about the relative impacts of allowing multi-channelling or additional FTA licences?

LECG's advice is attached to this submission.

Structure of the Submission

This submission is structured as follows:

Section 2 outlines the principles for reforms to the current regulatory framework the ACCC considers should be applied.

Section 3 examines the current state of the FTA market in Australia.

Section 4 discusses the potential costs and benefits of allowing FTA broadcasters to multi-channel, and concludes with some brief comments on implementation issues.

3 Principles for regulatory reforms

Current broadcasting regulation is based on a restrictive approach to supply of broadcasting. These restrictions include the current prohibition on multi-channelling by FTA broadcasters, limitations on datacasting and the number of FTA licences, and the current anti-siphoning regime.

These restrictions should be considered in the context of the objectives of the BSA, which include:

- promoting a diverse range of television services offering entertainment, education and information⁴
- promoting the role of broadcasting services in developing and reflecting a sense of Australian identity, character and cultural diversity⁵
- promoting high quality and innovative programming by providers of broadcasting services.⁶

The BSA also aims 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’.⁷

The promotion of competition is therefore one of the policy objectives listed in the BSA. However, it is potentially important for the achievement of other objectives. In particular, the elements of this last objective are related: increased competition has the potential to increase consumer choice and encourage the introduction of new and innovative service offerings. Thus, a more competitive broadcasting sector provides an effective means to better satisfy the diverse needs of Australian audiences.

Further, amendments to current regulations which promote competition and efficiency in the FTA sector, and increased competition between the FTA and pay TV sectors, are not inconsistent with the Government’s policy objectives of reflecting community standards and fostering a sense of Australian identity, character and cultural diversity. Increased competition can help achieve the diversity objectives of the BSA through promoting the provision of a greater number of services to consumers, with the continuation of minimum standards for Australian content on commercial TV.

That is, minimum standards can be set and broadcasters (with more liberal regulatory framework) can decide to enter or exit, or supply multi-channelled services, after

⁴ Section 3(1)(a) of the *Broadcasting Services Act 1992*.

⁵ Section 3(1)(e) of the *Broadcasting Services Act 1992*.

⁶ Section 3(1)(f) of the *Broadcasting Services Act 1992*.

⁷ Section 3(1)(b) of the *Broadcasting Services Act 1992*.

assessing current profits in the industry, their likely efficiency relative to the other broadcasters and the benefits of multi-channelling.

The Competition Principles Agreement provides that because regulations that restrict competition typically impose significant costs, the use of such regulations to achieve a particular policy outcome should only be used as a last resort and a clear social benefit that outweighs the costs of restricting competition should be identified and explained.⁸

In many regards the BSA appears to be in conflict with the Competition Principles Agreement. As the Productivity Commission (PC) noted in its inquiry report into broadcasting:

The [Broadcasting Services] Act predates the development of National Competition Policy, and is out of step with competition policy settings...Regulation should be targeted to achieve objectives rather than to balance *quid pro quos* among producers. Those regulations that do not contribute should be removed. Policies will also generally work better if they are set up so market forces and competition aid their achievement.⁹

The burden should therefore be on those arguing for continued regulatory restrictions on free and subscription broadcasting to demonstrate that the benefits of such policies outweigh the costs, and that the policy objectives can not be achieved using less restrictive means. The ACCC considers that, to date, this case has not been successfully argued.

In relation to the restrictive nature of broadcasting regulations, the National Competition Council, in its assessment of governments' progress in implementing the National Competition Policy, has stated:

The Commonwealth Government has addressed neither the benefits and costs to the community from these restrictions nor whether its objectives in broadcasting could be achieved without these restrictions. The Council assesses the Commonwealth as having failed to meet its NCP obligations, because it did not consider the major restrictions of competition against the CPA clause 5 principle.¹⁰

Another key element of effective regulation is that regulations should embody the principle of competitive neutrality—that similar services are regulated in a similar

⁸ See clause 5 of the Competition Principles Agreement which provides:

The guiding principle is that legislation (including Acts, enactments, Ordinances or regulations) should not restrict competition unless it can be demonstrated that:

- (a) the benefits of the restriction to the community as a whole outweigh the costs; and
- (b) the objectives of the legislation can only be achieved by restricting competition.

National Competition Council, *Compendium of National Competition Policy Agreements*, second edition, June 1998.

⁹ Productivity Commission, *Broadcasting*, Report no. 11, 2000, p. 8-9.

¹⁰ National Competition Council, *Assessment of governments' progress in implementing the National Competition Policy and related reforms: 2003 - Volume two: Legislation review and reform*, August 2003, p.11.7.

manner. Where similar services are regulated differently on the basis of how they are delivered, investment decisions may become biased simply by the presence of such regulations, which in turn may lead to allocative inefficiencies. Therefore it is important when developing a regulatory regime that applies to converging markets, that there is, as far as possible, competitive neutrality between the markets.¹¹

For example, datacasting has been defined in legislation as services transmitted using parts of the spectrum set aside for broadcasting. However, a service with the same content as a datacasting service could be transmitted over the internet or as an interactive service provided as part of a satellite or cable pay TV service and would not be subject to the same restrictions that apply to datacasting services.

Importantly, various regulations applying to the FTA TV sector should not be considered in isolation. The relationships between different policies mean that legislative amendments to the current restrictive regime should occur across-the-board, and not be limited to individual changes. Further, spectrum constraints limit the total supply of multi-channelling, HDTV, datacasting and additional FTA services.

Accordingly, while the DoCITA's Issues Paper seeks comments principally on issues concerning multi-channelling, the ACCC will comment on the impacts of multi-channelling restrictions, as well as other regulations affecting competition and efficiency in FTA and subscription broadcasting, in providing its recommendations.

A further important issue is the efficiency of spectrum use. The eventual conversion from analogue to digital transmission will free up substantial portions of the broadcasting spectrum, which has the potential to benefit consumers through the broadcasting of additional channels, interactive content, and higher definition audio and video, and/ or the provision of telecommunications services such as mobile and wireless services.¹² Therefore, the release of this spectrum provides potentially significant benefits via the supply of additional other services, and should therefore be a critical part of the Government's consideration in reviewing current broadcasting regulations.

¹¹ See for example: R. Albon and F. Papandrea, *Media Regulation in Australia and the Public Interest*, November 1998, p. 76.

¹² The ACCC notes that this may require significant changes to the current allocation and use of spectrum.

3 Current state of the FTA market

The ACCC's view when undertaking previous competition analysis in relation to subscription television, has been that while some substitutability exists between FTA and subscription services, retail FTA and subscription TV services are provided in separate markets.¹³

This view is based on several factors, including differences in funding (whether funding is primarily through advertising or subscription) and range of programming, and importantly the regulatory restrictions that limit the level of competition between FTA and subscription TV operators. Relaxation of some of these restrictions should increase the substitutability of FTA and subscription services and potentially require reconsideration of the current market separation.

Restrictions on competition are concerning given the concentrated nature of the FTA and pay TV markets. There are different ways to measure concentration in broadcasting markets. The first metric used by LECG in measuring the level of concentration was to use the number of licences in a particular licence area.¹⁴ It found that Australia has a high concentration of FTA licensed broadcasters in licence areas. Using the weighted average of the number of licences in local areas against population in those areas, the LECG report suggests that Australians on average have access to a total of 2.6 licensed commercial broadcasts, and 4.6 licensed broadcasts in total. This compares with US viewers who on average have access to 6.2 commercial broadcasts and Canadian viewers who on average have access to 3.5 commercial broadcasts.¹⁵

A comparison of the number of licenced Over the Air (OTA) broadcasters in US and Canadian cities comparable in size to the five Australian metropolitan cities shows that equivalent sized audiences in the US have access to at least twice as many OTA licensed broadcasters as Australian audiences in metropolitan cities, while Canadian city audiences can have access to even more OTA licensed broadcasters depending on their proximity to the US border.¹⁶

For the UK, LECG notes that every city in the UK comparable in size with the five major markets in Australia has five analogue FTA services. In addition, there are a number of FTA digital services, including Freeview with around 30 content streams.¹⁷

¹³ This was the view taken in assessing the competition implications of the subscription TV content supply arrangements between Foxtel and Optus and between Foxtel and Telstra in 2002. In assessing the retail market for pay TV services the Commission has found there is a retail market for the supply of pay TV services to members of the public wishing to subscribe to such services. Refer to ACCC, EMS report, p.61.

¹⁴ Spectrum based broadcasting licences are allocated by local areas in Australia.

¹⁵ LECG, *Impacts of removing multicasting regulations on competition and efficiency in commercial free to air and pay TV markets in Australia*, August 2004, p.17.

¹⁶ *ibid.*, p.18.

¹⁷ *ibid.*, p.19

The LECG report notes that the conclusion of higher relative concentration in Australia is reinforced if one was to expand the market definition to include the number of licensed subscription services over cable and satellite available to end-users.¹⁸

The second metric used by LECG—audience share of the top four broadcasters—reveals that Australia is more concentrated than all the other countries studied by LECG – the UK, US, Japan, Germany, Canada and South Korea.¹⁹

Another important factor to consider when assessing the state of the FTA market is whether incumbent broadcasters are receiving economic rents. It would be of concern if the barriers to entry created by current regulatory restrictions, including the prohibition on multi-channelling, are resulting in significant economic rents for FTA broadcasters. This would suggest that consumer choice is being restricted to the benefit of FTA broadcasters.

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.²⁰

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 next two years reaching in excess of 30 per cent by the 2007/08 financial year.²¹ 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.²²

¹⁸ *ibid.*, p.20.

¹⁹ *ibid.*, p.22.

²⁰ ABN AMRO, *Time to face the FACTS*, July 2002, p. 31.

²¹ ABN AMRO, *FTA television – the TV margin cycle*, 22 June 2004, p.21

²² *ibid.*, p.7

4 Impacts of multi-channelling

Given current spectrum allocation, the 7 MHz channel provided to FTA broadcasters can accommodate the broadcast of three or four separate signals using standard definition (576i) broadcasting.²³ However, the Government's 1999 decision to mandate high definition television (HDTV) broadcasting and require simulcast of HDTV and standard definition television (SDTV), restricts the opportunity for any multi-channelling by commercial FTA broadcasters under existing spectrum allocations.

While the commercial FTA operators can provide enhancements directly linked to programs simulcast on their analogue channel, they cannot use their digital spectrum to provide multi-channelling or pay TV services under current regulations.²⁴

The prohibition on multi-channelling by commercial FTA television broadcasters was a provision of the *Television Broadcasting Services (Digital Conversion) Act 1998*. At the time that this legislation was passed, the Government's stated reason for the prohibition on multi-channelling by the FTA broadcasters was to 'ensure that the developing pay TV sector is not unfairly disadvantaged by digital conversion of existing commercial and national television broadcasters'.²⁵

The market has changed substantially since the prohibition was made. These changes include the implementation of the pay TV agreements between Foxtel and Optus, Foxtel and Telstra, and Foxtel and Austar,²⁶ and the launch of Foxtel's digital pay TV service in March 2004. Pay TV subscribers had grown to 1.5 million at June 2003, and Foxtel's digital service had signed over 250,000 subscribers in the two months after its launch.²⁷ The pay TV sector has been given a clear and ample timeframe during which it has been afforded protection from potential competition from the FTA sector. The pay TV sector has previously argued that investment has been undertaken on the basis that the current prohibition on multi-channelling would last until 2006—this argument

²³ Productivity Commission, *Broadcasting Inquiry Report*, 3 March 2000, p. 227.

²⁴ An exception is that FTA broadcasters are allowed to multi-channel when certain events, such as sports matches, extend over time due to circumstances beyond the control of the broadcaster, and overlap with a regularly scheduled news program: *Broadcasting Services Act 1992*, Schedule 4, paragraph 19(8).

²⁵ Explanatory Memorandum, *Television Broadcasting Services (Digital Conversion) Bill 1998* and *Datacasting Charge (Imposition) Bill 1998*, p. 16.

²⁶ Significantly, these agreements involved the resale of Foxtel subscription television channels by Optus; bundling of broadband and telephony services by Telstra; the provision of certain pay TV rights for Austar; and a proposal for Foxtel to lease satellite capacity from Optus on the Optus C1 satellite.

²⁷ Jane Schulze, 'Pay TV ahead on digital: Foxtel', *The Australian*, 28 May 2004.

no longer applies.²⁸ It is difficult to see any credible reason why this protection should continue to apply.

The potential benefits of removing the prohibition on multi-channelling

Increased competition and greater consumer choice

Multi-channelling by FTA operators could heighten competition both between the FTA operators and between the FTA and pay TV sectors. The commercial FTA and public broadcasters could deliver additional services to consumers using multi-channelling. A commercial FTA provider could broadcast one or more additional channels to complement or provide substitute services to the primary channel. For example, news services could be staggered to service different consumer preferences, simultaneous sporting events could both be shown live, complementary channels could be developed and/or completely different content could be provided.

The number of additional channels would depend on the available spectrum. The current HDTV requirements and decisions on spectrum-use impinge upon the available spectrum and therefore the ability to multi-channel. One of the benefits of digital technology is that digital capacity is ‘dynamic’—it can be allocated between different services as required. There is no reason to assume a multi-channel would be 24 hours in its coverage. It would be possible to multi-channel during the time that the broadcaster is not using that spectrum to provide HDTV services. Therefore, HDTV and multi-channelling are not necessarily mutually exclusive.

In the US, there are more than 190 digital TV stations providing FTA multi-channelling incorporating both HDTV and SDTV.²⁹ The multi-channel services involve the provision of local news and weather broadcasts and multiple live sporting events where there are scheduling conflicts. In addition, some stations are carrying other network station’s programming as a sub-channel in areas in which the second network’s programming is unavailable digitally.³⁰ For example, the ABC owned station KFSN DTV service in Fresno, California provides three video streams. One stream replicates KFSN’s analogue signal including both prime time and sports HDTV. The second stream provides another full time video stream consisting repurposed local news and public affairs programming including political debates. The third video stream provides local weather information.³¹

Multi-channelling may permit FTA broadcasters to capture efficiencies in production, particularly in the production of sports programs. At a tennis tournament, for example,

²⁸ For example, see Foxtel, *Submission to Government on the report of the Australian Competition and Consumer Commission on Emerging Market Structures in the Communications Sector*, 25 July 2003, p.32

²⁹ John Eggerton and Ken Kerschbuamer, ‘Suddenly it’s hip to spectrum split’, *Broadcasting and Cable*, 8 December 2003, p.1.

³⁰ See Mark Shubin’s Monday Memo, July 19, 2004, at www.digitaltelevision.com/mondaymemo/mlist quoted in LECG, p.43.

³¹ *ibid.*

the 'key' match may be shown on the broadcaster's primary channel, and other matches could be shown via one of the multi-channels. Therefore, by using multi-channelling, FTA broadcasters may be able to make more or better use of what are typically expensive sports broadcasting rights. In this way multi-channelling may also provide public benefits in terms of greater consumer choice.

Multi-channelling may also provide some scope for additional revenue for FTA broadcasters as it permits greater audience targeting. Advertisers may be willing to pay a premium to target their advertising on specific consumer groups most likely to purchase their products.

The traditional business model for commercial FTA television involves FTA suppliers creating an audience to 'sell' to advertisers. The revenue from the 'sale' of audiences pays for the purchase of content necessary to attract audiences. LECG notes that an important feature of this model is that advertisers value some audiences more highly than others, based on factors such as their level of discretionary income and propensity to consume new products and switch supplier/brands.³²

If commercial FTA suppliers can provide a concentrated high value audience, advertisers may be willing to pay a higher cost per thousand viewers. However, under conditions of constrained FTA supply, there is limited scope to segment audiences such that FTA advertisers are likely to target broader audiences rather than possibly more valuable audience segments. This may result in some advertisers who wish to target specific segments switching to alternative electronic and non-electronic media which more accurately meet the viewing needs of particular consumer segments.³³

The fact that pay TV operators are concerned that multi-channelling will have a deleterious impact on their business,³⁴ lends some further support for the view that allowing commercial FTA broadcasters to multi-channel will promote greater competition between FTA broadcasters and pay TV providers.

In considering the potential for increased competition between pay TV and FTA broadcasters from allowing multi-channelling, it is worth noting the recent reports that BSkyB is developing a FTA satellite service for consumers in the UK. The Freesat service, set to begin later in 2004, will offer 116 television channels and 81 radio stations with the only cost to consumers being a one-time charge of £150 for the satellite antenna and set-top box.

³² *ibid.*, p.24

³³ The role of alternative media in meeting consumer preferences is discussed in further detail below.

³⁴ In the section 87B undertaking given by Foxtel to the Commission, Foxtel's commitment to digitise its pay TV network is conditional on, amongst other things, the Government not passing legislation which has the effect of allowing FTA operators to multi-channel prior to January 2007. The reason for this is that Foxtel holds the view that multi-channelling by FTA operators would have a material adverse impact on its pay TV business and therefore on Foxtel's decision to invest in providing a digital pay TV service.

Significantly, observers have viewed Freesat as a defensive response to the successful Freeview multi-channel digital terrestrial service (discussed below):

BSkyB needed to do something bold to counter the threat of Freeview, a lesser-known brand that two years ago began to offer a similar sort of one-payment plan. ... The service is already in some four million homes, far more than expected. ... Because BSkyB is so much bigger and its channel offering far more extensive than Freeview's, BSkyB's Freesat service is expected to be far higher profile and go much further in changing consumer perception of how to pay for TV.³⁵

The expectation is that many Freesat users will upgrade to paid packages to obtain premium sports and recent movies, for charges of up to £40 per month. Additionally, BSkyB could obtain greater advertising revenue from its own channels that would have the benefit of the Freesat viewership base.

Encouraging digital conversion

Despite the potential benefits discussed above, the competitive impact of allowing multi-channelling by FTA broadcasters would likely be limited in the short-term given the low penetration level of digital services.³⁶ This, however, also highlights an important potential benefit: that multi-channelling may encourage the take-up of digital receivers and transition towards full digital terrestrial services.

Galperin (2002) notes that the conversion to digital TV offers governments a number of opportunities:

First, it promises to alleviate the radio spectrum crunch created by the explosive growth in wireless telecommunications services by freeing up "prime real estate" frequencies (i.e., frequencies below 1GHZ). Second, digital TV may offer a lowcost gateway into the Information Society, thus helping to bridge the so-called "digital divide." Third, the transition has allowed governments to introduce pro-competitive reforms in the industry by lowering economic and regulatory barriers for market entry.³⁷

Similarly, Ofcom highlights a number of the benefits from the conversion from analogue to digital TV:

- Increased efficiency of spectrum use would provide the capacity for innovation in broadcasting techniques leading to the introduction of new interactive services.
- The barriers to entry associated with spectrum scarcity would be removed, and broadcasters would have capacity to compete more effectively for viewers and for advertisers.

³⁵ Wall Street Journal Online, 'Britain's BSkyB Offers a Flat Fee for Satellite TV', June 28, 2004 quoted in LECG, p.53.

³⁶ As at March 2004, 322,000 digital receivers had been sold. This represents 4.4 percent of the 7.2 million TV households in Australia.

³⁷ Hernan Galperin., 'Can the US Transition to Digital TV Be Fixed? Some Lessons from Two European Union Cases', *Telecommunications-Policy*. Feb.-March 2002; 26(1-2), p 5.

- Turning off the analogue terrestrial signal would release radio spectrum such that 112 MHz would become available across the UK, as well as a significant number of frequencies in the rest of the TV band not used to deliver the digital terrestrial television.
- Freed spectrum may be attractive to many providers of communications services and could be used to provide additional broadcasting services such as digital terrestrial TV channels, radio services and interactive services. Alternatively, the existing broadcasting transmitters could be used to send TV and some other forms of data to mobile devices. If the necessary international agreements were secured, the freed spectrum could provide capacity for new wireless communications services, such as mobile wireless broadband.³⁸

It is important to recognise that there are significant opportunity costs associated with the delay to digital conversion. These costs need to be considered by the Government in reviewing current broadcasting regulations. The PC's broadcasting inquiry report noted that an AT Kearney study, commissioned by Fairfax, estimated a net revenue benefit of \$600 million from releasing available spectrum ten years earlier than the scheduled date. The PC stated that there would be additional social and cultural benefits of greater media diversity which also need to be considered.³⁹ In the UK, Ofcom's April 2004 report entitled *Driving digital switchover a report to the Secretary of the State* noted that the joint DTI and DCMS cost-benefit analysis estimated that the benefits of digital switchover for the UK were in the order of £1.5bn to £2bn.⁴⁰

In addition to other enhancements such as interactive television, digital television can provide for greater picture and sound quality and/or for greater program choice. The present policy in Australia is focused only on the picture quality, by mandating HDTV but not allowing for multi-channelling. Improved picture quality may or may not be relatively important to take-up of digital services, depending partly on the price for consumer reception devices (digital televisions and STUs).⁴¹ However, relying solely on improved picture quality to encourage the take-up of digital services restricts the opportunity for services such as multi-channelling and the associated provision of additional content to provide additional impetus to the demand for digital services.

LECG notes that in the UK and Germany, multi-channelling has been a key element of the DTV transition, while in the US, HDTV, a digital tuner mandate, and cable carriage of digital signals are considered the main drivers of the DTV transition. In Canada, the

³⁸ Ofcom, *Driving digital switchover: a report to the Secretary of the State*, April 2004, pp.19-20.

³⁹ Productivity Commission, p.240.

⁴⁰ Ofcom, *Driving digital switchover: a report to the Secretary of the State*, April 2004, p. 17.

⁴¹ DVD is a significant driver for digital television as it has made superior picture and sound quality and the widescreen format more attractive. Another key driver is the price of Set Top Unit (STU) boxes – there are currently offering in the market place as low as \$199. There are also a growing number of single box offerings combining DVD and/or video and a digital tuner.

DTV transition is just beginning, with regulators focusing on HDTV as the main driver of transition.⁴²

In comparing these various strategies for encouraging digital take-up, LECG found that multicasting has facilitated the transition to digital television in the both the UK and Germany.

In the UK adoption of digital television was accelerated since the 2000 introduction of Freeview, with 3.5 million (out of 25 million) households having OTA digital service.⁴³ The Freeview service offers customers up to 30 digital television channels and over 20 digital radio stations, including seven BBC program services.⁴⁴ LECG notes that Freeview platform has provided a strong stimulus to the adoption of over the air digital television. Ofcom has stated:

The growth of digital TV in 2003 was strong, particularly in the fourth quarter. ... Most striking was the remarkable growth of Freeview, which exceeded almost all sales predictions. By the end of 2003, there were almost three million Freeview households, up from 1.2 million a year earlier.⁴⁵

LECG found that multi-channelling appears to have a significant impact on digital penetration, especially in markets where multi-channelling via other delivery platforms has limited penetration or availability.⁴⁶ In this regard, current restrictions applying to FTA broadcasting, such as the prohibition on multi-channelling, may function to reduce the incentives for the timely adoption of digital TV services. Increasing the potential for competition in FTA broadcasting, as well as between the FTA and Pay TV sectors, through the removal of regulatory impediments will likely drive customer choice and innovation, and therefore likely promote the take-up of digital services.

4.2 Potential costs of removing the prohibition on multi-channelling

FTA and pay TV operators have argued that there would be potential risks or costs associated with liberalisation of the multi-channelling provisions. Some FTA broadcasters have argued that multi-channelling may result in fragmenting of viewers across the various channels and, without an increase in advertising revenue, this audience fragmentation will lead to an effective decrease in program quality.

Experience in the United States and the United Kingdom is that irrespective of whether additional FTA advertising avenues become available, the total amount advertisers spend on FTA advertising stays relatively constant.⁴⁷ LECG found that in the US

⁴² LECG, p.36.

⁴³ Ofcom, Digital Television Update – Q1.

⁴⁴ LECG, p.37.

⁴⁵ Ofcom, *Driving digital switchover: a report to the Secretary of State*, p.24 quoted in LECG, p.49.

⁴⁶ LECG, p.5.

⁴⁷ In both the United Kingdom and the United States FTA television's share of the total advertising pool has remained stable at 33 per cent and 22 per cent respectively, over the period that new

audience fragmentation has served to increase the value of the remaining mass market audiences, leading to an increase in the price per viewer for broadcast network advertising. This increase in price has offset the revenue effect from reduced audiences.⁴⁸

If a FTA broadcaster chose to multi-channel, the total cost of programming would probably increase. The FTA broadcaster would be providing more content to consumers, but the operator's revenue from advertising may remain relatively constant. It might be argued that this will result in a reduction of discretionary spending and programming quality (such as an increased incentive to repeat programs).

While there is a possibility that multi-channelling may lead to a more fragmented audience and lower per channel revenues for broadcasters, consumers are likely to benefit from a greater choice of channel offerings which better match the preferences of Australian audiences. While consumer preferences are intrinsically hard to identify, FTA broadcasters may be in the best position to assess the viewing preferences of audiences. In this sense, allowing multi-channelling may enable FTA broadcasters to better meet the viewing needs of their audiences.

In a joint submission in response to the ACCC's EMS report, the Nine Network and Network Ten asserted that FTA multi-channelling would lead to a fragmentation of the available FTA audience as a result of the same number of viewers being spread across a greater number of channels. This fragmentation of the mass FTA audience and limited ability to generate advertising revenue would inevitably lead to a decline in quality across the FTA channels.

The Nine Network and Network Ten argued even if broadcasters were not obligated to multi-channel, if one broadcaster provided additional FTA channels competitive forces would lead to all broadcasters providing multi-channels, to the detriment of long-term stability and quality in programming.⁴⁹

Foxtel in its submission argued the collapse of ITV digital in the UK as illustrative of the risks of allowing free to air broadcasters to multichannel.⁵⁰ Austar also argued that FTA multi-channelling is not commercially viable option, other than on a subscription basis, in the medium term.⁵¹

entrants have gained advertising share: ABN AMRO, *FTA Television: Time to face the FACTS*, July 2002.

⁴⁸ LECG, p. 63.

⁴⁹ Nine Network Australia Pty Ltd and Network Ten Pty Ltd, *Comments to the DCITA in relation to the Australian Competition and Consumer Commission report to Senator Alston, Minister for Communications, Information Technology and the Arts on Emerging Market Structures in the Communications Sector*, July 2003, p 5.

⁵⁰ Foxtel, p.35.

⁵¹ Austar, *Response to the ACCC report to the Minister for Communications, IT & the Arts on emerging market structures in the communications sector*. 26 July 2003 p. 6.

In contrast, the Seven Network's submission supported the introduction of multi-channelling for commercial broadcasters. The Seven Network agreed with the ACCC's views that the multi-channelling could increase the potential for competition both within the FTA sector and between the pay TV and FTA sectors. The Seven Network argued that multi-channelling is key to the future viability of FTA TV, and that allowing commercial broadcasters to offer multi-channelled services would help promote digital television through the offer of increased choice to viewers.⁵²

The ACCC is sceptical about aspects of the argument that the introduction of multi-channelling would undermine the commercial viability of FTA television.

First, industry participants have argued that it is likely that were one FTA operator to begin offering services to end-users via multi-channelling, other FTA broadcasters would feel compelled to follow. This, however, is the precisely the nature of competition.

Second, with regard to the concerns expressed about the failure of the UK multi-channeller ITV Digital, it is not clear that the failure of ITV is indicative of broader issues of terrestrial multi-channelling services. Several complex factors contributed to the difficulties encountered in the UK digital terrestrial television sector, most of which appeared to be firm-specific. These included: that ITV Digital did not have premium sporting content and paid unsustainably high prices for second rate sporting products; high piracy rates; and the service was unreliable because of various technology problems. Additionally, ITV Digital faced strong competition from the established digital multi-channel satellite service delivered by BSkyB.

Indeed, the recent launch of the Top Up TV in the UK suggests that the failure of ITV may be not representative of the viability of such subscription based terrestrial multi-channelling service offerings. The Top Up TV service offers 10 pay channels for £7.99 monthly, plus a £9.99 "adult" service. Owners of the former ONDigital/ITV Digital boxes may subscribe, or viewers can purchase a new converter box with a compatible conditional access mechanism. As of 31 March 2004, there were about 3,500,000 Freeview households (out of 25 million UK households). Top Up TV is based on a business plan breakeven of 250,000 households.⁵³

Third, the Seven Network's backing of multi-channelling calls into question the arguments of the other FTA operators that multi-channelling will damage the FTA industry. Importantly, one of the reasons for the Seven Network's support appears to be a concern that audience fragmentation will increasingly occur in any event, as a result of increased penetration of pay TV and other communications services that provide an avenue for advertising.⁵⁴

⁵² Seven Network Limited, *ACCC's report on emerging market structures in the communications sector- Submission*, 31 July 2003, p.19.

⁵³ LECG p.38.

⁵⁴ There are also reports that other forms of marketing are becoming more important, such as direct mailing, telemarketing and sponsorships, although there are different views about whether this is cyclical or structural. The Australian Financial Review states: 'In the current economic environment,

The growth in popularity of alternative electronic media services, such as pay TV, games consoles, the internet and DVDs provides a significant threat to FTA broadcasters. Consumers are now offered a substantially greater volume and range of electronic media content options, across a growing range of delivery systems and playback devices. Furthermore, DVD, games and the internet are increasingly competing for the amount of time consumers devote to electronic media and communications devices.⁵⁵

As noted by LECG, under conditions of bandwidth scarcity and limited FTA supply, a large portion of the commercial FTA audiences may not be satisfied with the content available during peak viewing times.⁵⁶ Importantly, content targeted at the mass market may not suit certain viewer segments. The extent to which mass market programming satisfies the needs of viewers will be dependent on the profile of consumer preferences.

If consumer preferences become less homogeneous over time, the limitations of the FTA model to cater to the diverse tastes of consumers may result in audiences opting for other forms of electronic media.⁵⁷ In turn, the migration of FTA viewers to other forms of electronic media can be expected to result in advertisers following viewers and switching to alternative advertising services, including print, cinema, outdoor and others.⁵⁸

LECG notes that the growth in the number of channels has resulted in an increase in viewing times in most OECD countries.⁵⁹ Associated with this growth, the ‘generalist’ channels have lost viewer share while ‘thematic’ channels have retained and even increased their popularity in the face of greater competition. Similarly, Ofcom has stated that:

“Viewing is not only becoming more dispersed, it is becoming more polarized. Audience groups are diverging in what they watch. To an extent, there is even audience fragmentation on the terrestrial channels. It is, for instance, becoming increasingly difficult to reach mass audiences. Even in the late 1990s, the most popular programmes on terrestrial television could expect to attract audiences of 16-17 million; today 14 million is a common ceiling.... This is not the result of apathy across the viewing population. ... Instead, the cause of aggregate

many companies are also focusing harder on selling more to their existing customers rather than the costlier approach of finding and recruiting new customers. For many companies talking to existing customers means using non-advertising marketing tools.’ N. Shoebridge, ‘Channel-changing presents a terminal problem’, *The Australian Financial Review*, 17 February 2003, p.51.

⁵⁵ IDATE report for 2004, page 20 quoted in LECG, p 24.

⁵⁶ LECG, pp.24-25.

⁵⁷ In this regard, video recording via time shift may also potentially undermine the FTA business case.

⁵⁸ Although note previous comments in regarding the potential premium attached by advertisers to high rating content under conditions of audience fragmentation.

⁵⁹ The World Television Market Report 2004, IDATE, page 20 quoted in LECG, p.33.

audience declines is simply the fact that few programmes are now able to attract widespread interest *across* the age spectrum.”⁶⁰

Audience and advertising market “fragmentation” are significant trends in many international markets⁶¹, reflecting the substantial growth in the number of electronic media services available in homes.

LECG review of the Australian market notes that, while there has been some audience fragmentation, this has been modest, and that the four major FTA services retain a strong hold on overall consumption of electronic media in the Australian markets in which they operate. From the available evidence, the ‘generalist’ channels represented by the four major FTA services have suffered only a modest loss of viewer share to pay TV.⁶²

However, there are some trends that suggest if ‘thematic’ content streams were more widely available, similar fragmentation would have occurred in Australia. In this regard, LECG notes that the two non-commercial networks (ABC and SBS) increased their combined viewer share from 13.7 per cent in 1990 to 18.4 per cent by 1999.⁶³ In 1998, the most popular movie had a rating of 32.7 per cent whereas in 2002 the rating for the most popular movie had dropped to 13.9 per cent.⁶⁴

LECG contends that the relatively low level of audience fragmentation in Australia relative to many other markets does not suggest that Australian audiences are more homogenous in terms of their content preferences. Rather, the low level of fragmentation is more likely to suggest that the expression of audience preferences in Australia is being significantly constrained by the relatively limited set of options available.⁶⁵ There is scope to further understand trends in consumer preferences. However, care is required to retain a system based on a heavy emphasis on homogenous preferences when consumers appear likely to demand diverse offerings. Otherwise, in the longer term, FTA services will be undermined, even if FTA broadcasters can make significant profits in the immediate future.

4.3 Implementation issues

The exact benefits and costs of multi-channelling depend also on its implementation. The complicated FTA broadcasting rules means the Government will need to consider a number of issues.

⁶⁰ Ofcom, *Ofcom review of public service television broadcasting, Supporting Documents*, Vol. 1, part 4, at 4-9 (2004) (emphasis in original).

⁶¹ IDATE, *Op. cit.* page 20 quoted in LECG, p.34.

⁶² LECG, p.34.

⁶³ Australian Film Commission web site: article by Bob Walters.

⁶⁴ Australian Film Commission report drawn from AC Nielsen and OzTAM data at <http://www.afc.gov.au/gtp/wftvtopmovies02.html>

⁶⁵ LECG, p.34.

The Government would need to consider on what basis the primary channel of a broadcaster would be defined and whether current local content quotas applicable to the primary channel should be extended to any additional multi-channels. Furthermore, consideration would need to be given to the way in which digital spectrum is dynamically allocated to multi-channels taking account of the current HDTV requirements.

If multi-channelling by FTA broadcasters was allowed, the current anti-siphoning rules may need to be re-assessed. The current anti-siphoning regime should be amended in order to provide a balanced structure in which FTA broadcasters and Pay TV operators can compete. In this regard, it should be noted that the ACCC and the Productivity Commission have previously supported a 'dual rights' modification to the anti-siphoning provisions.

A dual rights regime means that neither pay TV nor FTA broadcasters can acquire exclusive rights to nominated events on a single list. The aim of this model is to maximise the availability of premium content to all broadcasters in Australia, while preventing migration of such content to subscription television broadcasters (e.g. premium sport). A dual rights regime can take a number of forms. For example, the United Kingdom has two tiers of sporting rights. The first tier can only be supplied to FTA operators. The second tier has dual rights.

Finally, overseas experience indicates that providing broadcasters with some flexibility to provide subscription services OTA may have additional benefits for consumers. LECG notes that some OTA broadcasters in the US and UK are providing subscription services which offer 'less for less' than cable/satellite pay TV services.⁶⁶ This would provide greater opportunities for consumers to choose a package of services that best suits their desired consumption of television. It may therefore be beneficial if the Government further analysed opportunities for subscription multi-channelling services.

⁶⁶ See, for example, LECG, p.41. See also www.usdtv.com and Emmis Communications, "Television Broadcasters Initiative Unveiled" (Press Release, April 20, 2004).