



**Australian
Competition &
Consumer
Commission**

Foxtel's Special Access Undertaking in relation to the Digital Set Top Unit Service

Discussion Paper

December 2006

Abbreviations

Act	<i>Trade Practices Act 1974 (Cth)</i>
Capex	capital expenditure
CRA	Charles River Associates
Commission	Australian Competition and Consumer Commission
DAA	digital access agreement
Digital Set Top Unit Service	Includes the following components parts: <ol style="list-style-type: none">1. Set Top Unit ('STU') Services which comprise the hardware used for the reception and decryption of signals of content in a customer premises.2. Conditional Access ('CA')/Service Information ('SI') systems which specifies how content can be accessed, and how the content is arranged within the broadcast transport streams.3. EPG Services which enables access seekers' channels to be displayed on Foxtel's electronic program guide.4. Modem Services which consist of services that enable provision of interactive content.
Foxtel	Foxtel Management Pty Ltd and Foxtel Cable Television Pty Ltd
IBAC	installed base acquisition costs
LTIE	long term interests of end users
PwC	PriceWaterhouseCoopers
RAPM	Regulatory Accounting Procedures Manual
SAOs	standard access obligations
Tribunal	the Australian Competition Tribunal

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1. Preface

FOXTEL Management Pty Ltd and FOXTEL Cable Television Pty Ltd (together ‘Foxtel’) lodged a special access undertaking (‘the Undertaking’) pursuant to s.152CBA, Division 5, Part XIC of the *Trade Practices Act 1974* (‘the Act’) with the Australian Competition and Consumer Commission (‘the Commission’) on 1 December 2006. The Undertaking specifies the terms and conditions upon which Foxtel undertakes to supply what it terms the “Digital Set Top Unit Service”.

Foxtel had previously lodged a special access undertaking in relation to the Digital Set Top Unit Service on 6 October 2005 (the ‘October 2005 Undertaking’). The Commission issued its draft decision (‘Draft Decision’) to reject the October 2005 Undertaking on 1 September 2006. Foxtel subsequently withdrew the October 2005 Undertaking 1 December 2006, and submitted a revised special access undertaking, which is now the subject of this Discussion Paper (‘the Paper’).

The Undertaking is substantially the same as the October 2005 Undertaking except that Foxtel has incorporated amendments designed to address the concerns of the Commission expressed in its Draft Decision to reject the October 2005 Undertaking.

Under Part XIC of the Act, the Commission must decide either to accept or reject a special access undertaking. The Act gives the Commission limited discretion to consider amendments/variations to a special access undertaking. Accordingly, Foxtel’s proposed changes to its October 2005 Undertaking has required the lodgement of a new special access undertaking and the Commission to undertake a new assessment process.

This Paper focuses on the amendments made in the revised Undertaking and provides the Commission’s preliminary views on the amendments. The Commission now seeks comment from interested parties on the revised Undertaking.

In addition, in light of extensive work already undertaken in assessing the October 2005 Undertaking and in the making of the Draft Decision, this Paper also provides the Commission’s preliminary views on whether to accept or reject the Undertaking.

The process the Commission will follow to assess the Undertaking will be open and public. Given the work that has already been undertaken in respect of the October 2005 Undertaking and the fact that this Paper puts forward preliminary views on the revised Undertaking, the Commission may not issue a draft decision on the Undertaking but rather may proceed directly to a final decision.¹ This may depend on the nature of views expressed in the course of public consultations. As such, parties are encouraged to make any submissions on the Undertaking at this stage of the process. The Commission will consider these submissions in deciding whether to accept or reject the Undertaking. The Commission will also take into account all the submissions previously put forward by interested parties in the assessment of the

¹ Under s. 152BV of the Act, the Commission is not obliged to provide a draft decision for public comment. The Commission has on prior occasions issued a draft decision, however, depending on the outcomes of this public consultation, a draft decision may not automatically be considered necessary in this case given that the Commission has already publicly consulted on a substantial part of the Undertaking.

October 2005 Undertaking in deciding whether to accept or reject the Undertaking, unless those interested parties state otherwise.

In addition to the Undertaking, Foxtel has provided a submission ('the Submission'), to the Commission in support of the Undertaking that includes two attachments. Foxtel also relies on the submissions, expert reports, answers to information requests and other evidence provided by Foxtel to the Commission in respect of the October 2005 Undertaking. These materials are listed in the appendix to Foxtel's Submission.

The public version of the Submission and the other material which form part of Foxtel's application are currently available on the Commission's website.

Interested parties who wish to obtain access to the confidential versions of these materials should follow the process outlined on the Commission's website at:

<http://www.accc.gov.au/content/index.phtml/itemId/772632/fromItemId/269280>

Submissions are to be received by the Commission by no later than 5 February 2007.

Please forward submissions to:

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Interested parties who make written submissions should preferably also provide submissions in electronic format.

The Commission will treat all submissions it receives as public, and will place written submissions on its website, unless an interested party specifically indicates to the Commission that it wishes to claim confidentiality in relation to all or part of a submission.

Parties who wish to claim confidentiality in relation to part of a submission should provide the Commission with both a confidential and public version of their submission. The public version should clearly indicate which portions are confidential and cannot be viewed by the public.

Any queries in relation to this Discussion Paper should be directed to Arek Gulbenkogl on 03 9290 1892 or via the contact details provided earlier in this Paper.

2. Background

2.1 ACCC's previous considerations of access to digital set top units and related services

2.1.1 Section 87B undertakings and digital exemption application

In November 2002, the Commission accepted s.87B undertakings from various parties, including Foxtel, in order to address competition concerns arising in relation to a content-sharing arrangement entered into between Foxtel and Optus.

These undertakings included a proposal by Telstra to invest in and to commence supplying a digital subscription television carriage service and for Foxtel to invest in and commence supply of digital set top unit and related conditional access services.²

The proposal to undertake the digital investment was contingent, amongst other things, on Foxtel and Telstra first obtaining anticipatory individual exemption orders under s.152ATA from the Commission in relation to the supply of a digital cable and digital satellite subscription television service. Towards that end, the undertakings also included a commitment from Foxtel and Telstra to apply for exemption orders in relation to the proposed digital investment within 28 days of the relevant legislation commencing.³

Telstra and Foxtel provided undertakings to commence supplying digital pay TV services within 12 months of obtaining an exemption order. Upon the commencement of the supply of digital pay TV services, access would be in accordance with the terms of the proposed Digital Access Agreements that accompanied and formed part of the exemption applications.

The applications for exemption were lodged by Foxtel and Telstra in late December 2002. After undertaking a public inquiry, the Commission made a final decision to accept Foxtel's and Telstra's applications, subject to certain conditions, on 12 December 2003.⁴

In accepting Foxtel's and Telstra's applications, the Commission concluded that granting the exemptions would promote the long-term interest of end-users ('LTIE') because the investment in a digital service was more likely to occur with an

² See generally clause 6 of the Telstra section 87B undertaking and clauses 4 and 5 of the Foxtel section 87B undertaking in relation to the proposal for digital investment and a digital access regime.

³ At the time the section 87B undertakings were given, the legislative regime under which Telstra and Foxtel would apply for their anticipatory individual exemption orders had not been passed. The legislative scheme under which the exemption orders were sought was passed on 10 December 2002 and commenced on 19 December 2002.

⁴ Section 152ATA(6) establishes that the Commission must not grant an exemption order unless the Commission is satisfied that the making of the order will promote the long-term interests of end-users of carriage services or of services provided by means of carriage services ('the LTIE'). The matters that the Commission must have regard to when determining whether a particular thing promotes the LTIE are set out in section 152AB.

exemption order than without one. The Commission was satisfied that the exemptions would facilitate the investment and therefore lead to the efficient investment in infrastructure. Further, a primary part of whether competition would be promoted was whether there would be an effective access regime in place. The Commission considered that granting the exemptions would promote competition because Foxtel's Digital Access Agreement and Telstra's Access Agreement would provide for a more effective form of access, with the additional conditions specified in the final exemption decision as compared to the original access terms proposed by the parties in their s.87B undertakings.

While the general form and content of the proposed Digital Access Agreements were available to the Commission as part of its consideration of the s.87B undertakings, the exemption process provided an opportunity to clarify and refine many aspects of the Digital Access Agreements.

2.1.2 Tribunal's decision to refuse exemption applications

Subsequent to the Commission making its final decision to accept Foxtel's and Telstra's applications, the Seven Network lodged an application for review of the Commission's decision with the Australian Competition Tribunal ('the Tribunal'). On 30 September 2004, the Tribunal issued its decision to refuse the applications for exemption by Foxtel and Telstra. The reasons for that decision were released on 23 December 2004.⁵

In reaching its decision to refuse the applications for exemption by Foxtel and Telstra, the Tribunal emphasised that the test to be applied in making an exemption decision under s.152ATA is that the making of the order is in the LTIE; s.152ATA(6) and stressed the importance of focusing on this criteria, rather than the reasonableness of conditions of access.

The Tribunal rejected the applications because it concluded that it could not be said that the granting of an exemption order would promote the LTIE.

In addition, the Tribunal expressed concerns about the following non-price terms and conditions in Foxtel's undertaking:

- the exclusion of interactivity from the digital services offered by Foxtel;
- the tie of access to the Basic Package under Foxtel's terms and conditions; and
- the period of the undertakings and the length of the exemption period.

In relation to the pricing methodologies put forward by Foxtel and Telstra, the Tribunal concluded that it was generally satisfied with Foxtel's methodology, as modified by the Commission. It did consider, however, that a more rigorous verification of the cost inputs would be appropriate.

2.1.3 Existing access regime for digital STUs

Even without exemption orders, the s.87B undertakings submitted by Foxtel and Telstra include a commitment that if the parties commence supplying a digital pay TV

⁵ Seven Network Ltd (No 4) [2004] ACompt 11 23 December 2004

service at any time prior to 31 December 2007, third party access will be provided in accordance with the terms and conditions contained in the Foxtel and Telstra Digital Access Agreements.⁶ On 1 December 2006, Foxtel provided a letter to the Commission stating that it intends to extend its s.87B Digital access undertaking until 31 December 2015.

Foxtel commenced supplying a digital pay TV service on 14 March 2004. This factor in combination with the Tribunal's decision to refuse Foxtel and Telstra's anticipatory exemption applications means that access seekers can use Foxtel's access undertakings pursuant to s.87B to gain access to Foxtel's STU and related services.

It should be noted that Foxtel's s.87B undertaking was varied on 18 December 2003 as part of its exemption application process. The varied versions of the Foxtel undertaking and related Digital Access Agreement are those that are currently in force. These are available on the Commission's web site at <http://www.accc.gov.au/content/index.phtml/itemId/451865>.

2.1.4 Commission's draft decision to reject the 2005 Undertaking

On 6 October 2005, Foxtel lodged a special access undertaking with the Commission in relation to the proposed supply of Digital Set Top Unit Services.

On 1 September 2006, the Commission issued its Draft Decision to reject the October 2005 Undertaking. This Draft Decision was based on the view that the Commission could not be satisfied that the bundling provisions specified in the October 2005 Undertaking were consistent with the obligation imposed by s.152AR(3)(a) to supply the declared services to an access seeker on request.

The Commission was, however, satisfied that the terms and conditions specified in the October 2005 Undertaking were reasonable pursuant to s.152CBD(2)(b).

The Commission noted some minor concerns with the non-price terms and conditions relating to indemnities and liabilities, and the access provider's ability to change the terms of the Digital Access Agreement (DAA). The Commission also noted that it would prefer to have further information regarding the cost base that Foxtel has used in calculating the Installed Based Acquisition Cost (IBAC) and the marketing costs to be included in future periods as part of its pricing methodology.

Notwithstanding these concerns, the Commission's draft view was that, on balance, it was satisfied that the terms and conditions specified in the October 2005 Undertaking were reasonable.

Subsequent to the Commission issuing the Draft Decision, Foxtel withdrew the October 2005 Undertaking on 1 December 2006, and lodged a revised special access undertaking on that same date.

⁶ Foxtel and Telstra's digital access undertakings are in force until 31 December 2007. Foxtel and Telstra have the option to extend these undertakings until 31 December 2015.

3. The Legislative Criteria for the Assessment of Undertakings

3.1 Legislative criteria

Under s.152CBA of the Act, a special access undertaking can be lodged by a person who is, or expects to be, a carrier or a carriage service provider, so long as the service is not an active declared service.

Section 152CBD of the Act specifies that the Commission must not accept the special access undertaking unless:

- the Commission is satisfied that the terms and conditions set out in the undertaking would be consistent with the standard access obligations (the SAOs) under s.152AR;
- the Commission is satisfied that the terms and conditions set out in the undertaking are reasonable;
- the Commission is satisfied that the undertaking is consistent with any Ministerial pricing determination; and
- the Commission has:
 - published the undertaking and invited people to make submissions to the Commission on the undertaking; and
 - considered any submissions that were received within the time limit specified by the Commission when it published the undertaking.

A service supplied by a person who has given the Commission a special access undertaking and which the Commission has accepted, is a “deemed” declared service under s.152AL(7) of the Act.⁷ However, the Commission may still declare a service under s.152AL(3) even if the service is covered by a special access undertaking.

3.1.1 Consistency with standard access obligations

The SAOs are set out in s.152AR of the Act. Subject to class or individual exemptions made by the Commission, a carrier or carriage service provider must comply with the SAOs in regard to declared services it supplies either to itself or to

⁷ Under Part XIC of the Act, the Commission may declare carriage services and related services to be declared services. Carriers and carriage service providers who provide declared services are required to comply with standard access obligations (‘SAOs’) in relation to those services. The SAOs facilitate the supply of declared services by access providers to access seekers, in order that access seekers can provide carriage services and/or content services.

other persons.⁸ Specifically, s.152AR requires access providers to, among other things:

- supply an active declared service if requested to do so by a service provider (subject to certain limitations) and to take all reasonable steps to ensure that the technical and operational quality of the active declared service supplied to the service provider is equivalent to that which the access provider provides to itself;
- take all reasonable steps to ensure that the service provider receives, in relation to the active declared service supplied to the service provider, fault detection, handling and rectification of a technical and operational quality and timing that is equivalent to that which the access provider provides to itself;
- if an access provider supplies an active declared service by means of conditional-access customer equipment, the access provider must, if requested to do so by a service provider, supply to the service provider any service that is necessary to enable the service provider to supply carriage services and/or content services by means of the active declared service and using the equipment;
- permit the interconnection of the facilities an access provider either owns, controls or is responsible for, with the facilities of a service provider for the purpose of enabling the service provider to be supplied with active declared services; and
- provide billing information (if requested by the service provider) at certain intervals and in a certain manner and form.

Under s.152CBA(3), the undertaking must state that the person who supplies the service agrees to be bound by the applicable SAOs and undertakes to comply with the terms and condition of the undertaking in relation to the obligations.

The Commission will assess whether the Undertaking would be consistent with the SAOs.

3.1.2 Terms and conditions are reasonable

An important part of the access regime is the terms and conditions of access (including the price or a method for ascertaining the price). Under Part XIC of the Act, the Commission cannot accept an undertaking unless it is satisfied that the terms and conditions specified are reasonable. In determining whether terms and conditions are reasonable, regard must be had to the following matters:

- whether the terms and conditions promote the LTIE;
- the legitimate business interests of the carrier or carriage service provider concerned, and the carrier's or carriage service provider's investment in facilities used to supply the declared service concerned;
- the interests of persons who have rights to use the declared service concerned;
- the direct costs of providing access to the declared service concerned;

⁸ Refer to ss.152AS and 152AT of the Act.

- the operational and technical requirements necessary for the safe and reliable operation of a carriage service, a telecommunications network or a facility; and
- the economically efficient operation of a carriage service, a telecommunications network or a facility.⁹

This does not, by implication, limit the matters to which regard may be had.¹⁰

In considering whether the terms of an access undertaking promote the LTIE, the Commission must consider the achievement of the following objectives:

- promoting competition in markets for telecommunications services;
- achieving any-to-any connectivity in relation to carriage services that involve communication between end-users; and,
- the objective of encouraging the economically efficient use of, and economically efficient investment in:
 - the infrastructure by which listed carriage services are supplied; and
 - any other infrastructure by which listed services are, or are likely to become, capable of being supplied.¹¹

3.1.3 Consistency with Ministerial pricing determination

Division 6 of Part XIC provides that the Minister can make a written determination setting out principles dealing with price or a method of ascertaining price relating to the SAOs. Section 152CI(1) of the Act provides that if a provision of an access undertaking is inconsistent with any Ministerial pricing determination, the provision will have no effect to the extent of the inconsistency.

The Minister has not made a pricing determination in relation to the Digital Set Top Unit Service.

3.1.4 Published the undertaking and invited people to make submissions

In accordance with ss.152CBC(6)(a) and 152CBD(2)(d), the Undertaking was published by the Commission in December 2006 on the date this Paper was released.

Parties are invited to make submissions to the Commission on the Undertaking. Any such submission must be received by the Commission on or before 5 February 2007

If, prior to the expiry of this period, the Commission makes a request of the access provider, under s.152CBB, for further information about the Undertaking, the period is extended by the time taken for the request to be fulfilled.

⁹ s.152AH(1)

¹⁰ s.152AH(2)

¹¹ s.152AB(2)

4. The Commission's Process for Assessing the Undertaking

The process the Commission will follow to assess the Undertaking will be as open and public as practicable allowing parties to express their views on the Undertaking, provide relevant information to assist the Commission and allow comment on the preliminary views formed by the Commission on the Undertaking.

4.1 Time limit for assessment

The Act imposes a time limit for the Commission's assessment of undertakings. While the Commission would intend to make its decision as soon as is practicable for it to do so, the Commission must in any event make a decision within 6 months. If it does not do so, it is deemed to have accepted the Undertaking. However, the Commission is able to extend its decision-making period for up to 3 months at a time provided it gives a reason for doing so. In addition, if the Commission requests further information in relation to the Undertaking, the time taken for the Commission to receive the information is excluded from the 6 month period. Similarly, the consultation period specified by the Commission is excluded from this timeframe.¹²

4.2 Process

As noted earlier herein, the Undertaking is in substantially the same form as the October 2005 Undertaking on which the Commission has already publicly consulted and issued its Draft Decision (September 2006). Notably, however, the October 2005 Undertaking was withdrawn by Foxtel prior to any Commission final decision being made. As such, no final view has been expressed by the Commission on the undertaking (in whatever form).

Nevertheless, the Commission believes that it is appropriate to draw on the analysis conducted in respect of the October 2005 Undertaking process in forming its views on the revised Undertaking.

With this in mind, the Commission intends to adopt the following process in assessing Foxtel's Undertaking.

Stage 1: Lodgement of Undertaking

The Undertaking submitted to the Commission by Foxtel on 1 December 2006 which consists of:

- covering letter from Foxtel dated 1 December 2006;
- Foxtel's Undertaking; and
- Foxtel's Submission and attachments.

Foxtel's application also relies on the submissions, expert reports, answers to information requests and other evidence provided by Foxtel to the Commission in

¹² See s.152CBC (5), (6) & (7).

support of the October 2005 Undertaking. The appendix to Foxtel's Submission contains a list of this material.

Stage 2: Publish the Undertaking and Discussion Paper and seek submissions on the Undertaking and the Commission's preliminary views

The Commission's aim in this process is to encourage interested parties to comment on the amendments. That is, the Commission has focussed this Paper on those parts of the Undertaking that have been revised since the October 2005 Undertaking. This is not to preclude public comment on the whole of the Undertaking. Interested parties may comment on any or all aspects of the Undertaking.

This Paper therefore seeks comment from interested parties on Foxtel's Undertaking, and especially the revised aspects. It also provides the Commission's preliminary views on the proposed amendments. In light of the extensive analysis that has already been undertaken in respect of the October 2005 undertaking, this Paper also provides the Commission's preliminary views on whether to accept or reject the Undertaking.

Stage 3: Receive submissions

The Commission will allow until 5 February 2007 in which to provide written submissions on the Undertaking. In relation to the making of submissions, the Commission notes the following.

While the Commission will have regard to all submissions that are made to it on or before the closing date for submissions, the Commission strongly encourages all interested parties to make their submissions as soon as they are able.

The Commission also encourages parties to make their submissions in a way that facilitates the efficient assessment of its various contentions, including the verification of any facts or data upon which those contentions are based. In this regard, parties are encouraged to restrict confidentiality claims to a minimum and to establish appropriate confidentiality regimes for the disclosure of any information that is claimed to be confidential to interested parties or to others to allow their critical assessment. Accordingly, the Commission would recommend that should a party intend to provide confidential material in support of a submission, that it now put in place pro forma documentation (a confidentiality undertaking and procedure for responding to requests) to facilitate the prompt disclosure of that information to appropriate third parties.

Should the Commission not be in a position to efficiently assess a party's contentions, including by receiving the results of independent critical assessments of them, it will be necessarily constrained in the weight to which it will be able to attach to those contentions. This will particularly be the case where conflicting material is before the Commission that has been critically assessed.

Stage 4: Commission to assess the Undertaking

The Commission will assess the Undertaking having regard to the relevant statutory criteria as noted earlier herein. In doing so, the Commission will not simply be assessing the revisions to the Undertaking, but rather, will be considering the whole of the Undertaking since the Commission has not at any point expressed a final view on the terms and conditions of the Undertaking, including those matters that were dealt with (at least to the draft decision stage), in the October 2005 Undertaking.

As such, this stage of the process involves the Commission forming a view on the whole of the Undertaking.

Stage 5: Publish assessment

As previously noted, depending on the outcome of public consultation, the Commission may not issue a draft decision on the Undertaking but rather may go straight to final decision on the Undertaking. The Commission has previously consulted on the vast majority of the Undertaking and the Commission will take into account the submissions of interested parties in response to the October 2005 Undertaking as well as submissions received in response to this Paper in deciding whether to accept or reject the Undertaking.

Furthermore, in relation to the amendments, the Commission is providing its preliminary view on those matters for interested parties to respond to.

4.3 Confidentiality

In general, the Commission is of a view that all information and submissions it proposes to take into account in assessing the Undertaking should be publicly disclosed. This enables persons with an interest in the Undertaking to comment on matters affecting their interests, and enables the Commission to test the veracity of the information. As noted above, parties are encouraged to restrict confidentiality claims to a minimum and to establish appropriate confidentiality regimes where necessary.

However, the Commission is aware of the need to protect certain of Foxtel's information where disclosure of such information may harm Foxtel's legitimate commercial interests. Therefore, in order to balance the possible harm from disclosure and the harm that interested persons may suffer if they are unable to comment on matters affecting their interests, the Commission considers that a more limited form of disclosure may be appropriate. For example, Foxtel may require that parties who wish to have access to confidential information sign confidentiality undertakings.

In this regard, the Commission believes that such confidentiality undertakings should enable the relevant party to view all information supplied by Foxtel to the Commission in these proceedings. Should Foxtel choose not to supply any confidential information to parties who wish to have access to it, the Commission may decide to give lesser weight to such information if it is not available to parties who have an interest in it, and the veracity of it can not be tested by the Commission to its satisfaction.

For further information in relation to obtaining access to confidential submissions, parties should refer to the processes outlined on the Commission's website at

<http://www.accc.gov.au/content/index.phtml/itemId/772632/fromItemId/269280>

or contact Arek Gulbenkoglou on (03) 9290 1892.

5. Summary of the Undertaking

The Undertaking specifies the terms and conditions on which Foxtel undertakes to supply what it terms the Digital Set Top Unit Service to access seekers, and meet its standard access obligations under s.152AR of the Act to the extent that those obligations would apply to Foxtel if the Digital Set Top Unit Service were treated as an active declared service.

In addition to the body of the Undertaking, there are three appendices attached:

1. Appendix 1 provides a service description of Foxtel's Digital Set Top Unit Service.
2. Appendix 2 comprises the Foxtel Digital Access Agreement (the 'DAA') which sets out the price and non-price terms and conditions of access to its Digital Set Top Unit Service
3. Appendix 3 attaches a Confidentiality Deed which sets out the terms of any disclosure of confidential information between Foxtel and access seeker pursuant to the DAA.

The following discussion outlines the revised Undertaking being proposed by Foxtel and, more specifically, the nature of the amendments to the October 2005 Undertaking.

5.1 The October 2005 Undertaking

In October 2005, Foxtel lodged a special access undertaking with the Commission in relation to the proposed supply of Digital Set Top Unit Service. Foxtel's October 2005 Undertaking is summarised in Chapter 4 of the Commission's Draft Decision.

Following initial public consultation, the Commission issued its Draft Decision to reject Foxtel's October 2005 Undertaking on 1 September 2006.

The Commission received one submission (from Seven Network Ltd) in response to the Commission's Draft Decision. Foxtel chose not provide a submission in response to the Draft Decision.

The Draft Decision was based on the view that the Commission could not be satisfied that the bundling provisions specified in the October 2005 Undertaking would be consistent with the obligation imposed by s.152AR(3)(a) to supply the declared services on request.

This issue arose from the Commission's understanding of Foxtel's intention that the services covered by the October 2005 undertaking should not only include the bundled Digital Set Top Unit Service, but also the various unbundled components of that service and the inclusion of a term that prevented an access seeker from obtaining access to component services other than as part of the bundled Digital Set Top Unit Service.¹³

A service supplied by a person who has given the Commission a special access undertaking and which the Commission has accepted, is a declared service under s.152AL(7) of the Act. If the special access undertaking was accepted, s.152AR(3)(a)

¹³ See clause 4.1(c)(ii) of October 2005 undertaking

would in essence require Foxtel to supply any or each of these services to an access seeker where requested to do so by that access seeker.

The Commission considered that the effect of the bundling clause was to allow Foxtel, under the October 2005 Undertaking, to refuse to supply individual component services to access seekers. On this basis, the Commission could not be satisfied that the bundling clause would be consistent with the obligation imposed by s.152AR(3)(a) to supply the services on request.

The Commission was satisfied that the terms and conditions specified in the October 2005 Undertaking were reasonable as required by s.152CBD(2)(b).

The Commission did, however, have some minor concerns about the non-price provisions in relation to indemnities and liabilities, and the access provider's ability to change the terms of the DAA. Similarly, while the Commission took the view that, overall, the price terms and conditions would promote the long-term interests of end-users, it noted that it would prefer to have more information about the cost base that Foxtel has used in calculating the Installed Base Acquisition Cost ('IBAC') as part of its pricing methodology and the method by which Foxtel would exclude Foxtel-specific marketing costs in future periods.

Notwithstanding these concerns, the Commission's draft view was that, on balance, it was satisfied that the terms and conditions specified in the October 2005 Undertaking were reasonable.

5.2 The revised Undertaking

Foxtel withdrew the October 2005 Undertaking on 1 December 2006 prior to the Commission making its final decision on the October 2005 Undertaking.

Foxtel simultaneously lodged a revised Undertaking based largely on the October 2005 Undertaking, but with amendments aimed at addressing the Commission's concerns noted above. The amendments made to the October 2005 Undertaking are outlined in the **table 1** below.

Significantly, the Undertaking now specifies that it is in relation to *only* the Digital Set Top Unit Service (as a bundled service) and *not* the individual component services that comprise the service.¹⁴ This modification is squarely aimed at overcoming the issue of consistency with the standard access obligation to supply the declared service on demand.

In addition, Foxtel has also made some other amendments to the October 2005 Undertaking to address the lower order concerns of the Commission regarding the reasonableness of the price and non-price terms and conditions as noted in the Draft Decision.

¹⁴ Foxtel's modification leaves it open for the Commission to declare the component services and require arbitrated access to these services. The Commission indicated in its Draft Decision on the October 2005 Undertaking that, on the available evidence, the component services appear to be contestable inputs and not, of themselves, bottleneck elements in the supply of subscription television services.

Table 1 - Changes to the October 2005 Undertaking

Issue	Amendments in the revised undertaking
Consistency of terms and conditions in the undertaking with the applicable SAOs	Clause 2.7 of the undertaking states that the undertaking is only in relation to the supply of the Digital Set Top Unit Service and is not an undertaking in relation to the supply of each component service. Digital Set Top Unit Service is now referred to in the singular throughout the DAA.
Indemnities and liabilities	Clause 23.3 of the DAA has been amended to make exclusions of liability apply to both parties rather than just the access seeker.
Access provider's ability to change the Digital Set Top Unit Service and terms of the DAA	<p>Clause 4.4(b) of the DAA has been amended to extend the required notice periods before a Change can be enacted (from 1 month to 2 months and from 3 months to 6 months in sub-clauses (b)(ii) and (iii) respectively).</p> <p>Clause 11.2(b) of the DAA has been amended to provide that reasonable prior notice of a Modification is not less than 1 month's notice.</p>
Charges for faults	Clause 6 in Schedule 2 of the DAA is amended to separately deal with faults caused and contributed by the access seeker and faults not caused and contributed by the access seeker. so that where a Fault is notified by the access seeker and it is not caused nor contributed to by Foxtel or the access seeker, then the costs will be shared equally between Foxtel and the access seeker.
EPG	Clause 5.2 (e) in the DAA has been deleted to allow all subscribers to view the Access Seekers channels listing on Foxtel's EPG.
Pricing methodology	<p>Clause 2.6 has been inserted in the undertaking to provide that Foxtel will arrange for an independent review of:</p> <p>(a) the calculations made pursuant to the DAA used to prepare the Rate Card; and</p> <p>(b) the process undertaken by Foxtel management to identify and separate general marketing costs from channel specific and other specific marketing costs for the purposes of ascertaining the Defined Capital Expenditure in Schedule 3 of the Digital Access Agreement,</p> <p>after the first 12 months and thereafter every 3 years and will provide a copy of the report to the Commission.</p> <p>The definition of "Defined Capital Expenditure" in Schedule 3 of the DAA has been amended to exclude marketing devoted to a single Subscription Television Service on Foxtel's tier.</p> <p>Clause 3.5(c) of Schedule 3 to the DAA has been amended to exclude marketing solely devoted to a single Subscription Television Service on FOXTEL on a tier from the marketing costs to be depreciated over 3 years.</p> <p>The cable and satellite IBAC costs pools have been updated in Schedule 3 of the DAA.</p>
Attributable costs categorisation	<p>The definition of Attributable Capex Costs in Schedule 3 of the DAA has been amended to specify that Attributable Capex Costs does not include the cost of:</p> <ul style="list-style-type: none"> • any Required Network Enhancements paid by the Access Seeker pursuant to clause 9.1(ii)(B); or • any Satellite Enhancements paid by the Access Seeker pursuant to clause 9.2(g)(i).
Confidentiality Deed	An appendix 3 has been added to the DAA to include a Confidentiality Deed to deal with the disclosure of confidential information between Foxtel and access seeker under the DAA.

All of these proposed modifications are in “marked-up” format in a version of the Undertaking posted on the Commission’s website.

The amendments to the terms and conditions relating to charges for fault repairs and EPG services were previously proposed by Foxtel in the context of the October 2005 Undertaking assessment process and considered by the Commission in reaching its Draft Decision.

5.4 The Commission’s preliminary view on the revised Undertaking

This section outlines the Commission’s assessment and preliminary views – subject to public consultations – on the Undertaking in light of its previous Draft Decision and the effects of the amendments to the revised Undertaking.

Consistency with the SAOs

Whether the bundling clause would be consistent with section 152AR(3)(a)

The Commission’s concern with the October 2005 Undertaking was that it would not be consistent with the obligation to supply the declared service pursuant to section 152AR(3)(a) should the Undertaking be accepted and the service became an active declared service. This view arose because of the bundling clause in the Undertaking which provided access to the bundled Digital Set Top Unit Service, but due to the effect of clause 4.1(c)(ii), not the unbundled components of the service, such as the STU and CA Services (see Appendix 1 of the revised Undertaking).

Once the Commission accepts a special access undertaking and the undertaking comes into operation, the service supplied by the person becomes a declared service.¹⁵ By operation of sections 152CBD(2) and 152CBA(3), the terms and conditions of the Undertaking must be consistent with the obligations in section 152AR, and in this particular instance, section 152AR(3)(a) – the obligation to provide the service to an access seeker upon demand.

The Commission formed the draft view that the October 2005 Undertaking would not be consistent with this obligation as the “deemed” declared service would be the bundled Digital Set Top Unit Service and the individual component services, but the Undertaking would only oblige Foxtel to supply the bundled Digital Set Top Unit Service.

Under the amended clause 2.7 of the revised Undertaking, Foxtel states that the Undertaking is only in relation to the supply of the bundled Digital Set Top Unit Service and not in relation to the supply of each component service. This is reflected in Schedule 1, Parts A, B, C and D of the DAA and throughout the DAA where the applicable service is now referred to in the singular rather than plural indicating that there is only one Digital Set Top Unit Service and not individual component services.

Clause 4.1(c)(ii) remains in the revised DAA such that Foxtel is only obliged to supply the Digital Set Top Unit Service as a bundled package of services under that agreement. However, because the relevant terminology has been modified, it is now

¹⁵ Section 152AL(7)

clear in the Undertaking itself that the Undertaking only applies to the bundled service and the Undertaking does not have the effect of withholding supply of the component services that make up the Digital Set Top Unit Service.

The obligation under section 152AR(3)(a) is to supply the declared service to the access seeker on demand. The deemed declared service in the context of the revised Undertaking would be the bundled Digital Set Top Unit Service only. The revised Undertaking would oblige Foxtel to supply the bundled service. In this context, the Commission's preliminary view is that bundling clause would appear to be consistent with the standard access obligations under section 152AR(3)(a).

Whether the tying clause would be consistent with section 152AR(3)(a)

In the Draft Decision, the Commission noted the parties' submissions on whether the 'tying' clause would be consistent with the obligation to supply the declared service, however, it refrained from expressing a firm view on this issue, partly because the Commission had already found that the bundling clause was not consistent with the standard access obligations and therefore it did not need to determine the tying issue.

The Commission's preliminary view of this issue as noted above, would indicate that the bundling clause issue might be overcome by the amendments made to Foxtel's Undertaking. As such, the Commission is required to address and determine whether the tying clause would also be consistent with section 152AR(3)(a).

The tying provisions are contained in clause 4.1 of the revised Undertaking and in particular clauses 4.1(c) and (f). Generally speaking, they provide that Foxtel is only obliged to supply and continue to supply a Digital Set Top Unit Service where the Digital Set Top is actually in use by a subscriber to Foxtel's retail subscription TV services. In short, the effect of the tying provisions in the Undertaking is that Foxtel will only supply its Digital Set Top Unit Service to Foxtel subscribers.

The Commission has noted the submissions of Foxtel and interested parties in its Draft Decision on this issue. In addition to these submissions, Foxtel, in its supporting submission to the revised undertaking argues that the tying clause should be viewed simply as a bona fide term of supply of the active declared service and not a limitation on the Undertaking pursuant to section 152CBA(5).¹⁶

Taken in this context, the "deemed" active declared service is the supply of the Digital Set Top Unit Service to all potential subscribers and not just Foxtel subscribers. Foxtel argues that the Undertaking provides for the supply of the Digital Set Top Unit Service to access seekers, but a term of supply is that Foxtel undertakes to supply the service only in relation to certain homes (ie: Foxtel subscribers). As such, Foxtel argues that there is no inconsistency with the obligation to supply the declared service, as Foxtel is supplying the Digital Set Top Unit Service, but in this case, only to Foxtel subscribers. Foxtel submits that the tying clause should instead only be assessed against whether the terms are reasonable.

Foxtel also submits that this geographic term of supply is consistent with the obligation to supply the declared service because the obligation does not contemplate that Foxtel should be forced to supply a service where it is not in fact supplying a service to itself.¹⁷ The Commission understands that Foxtel's interpretation of an

¹⁶ Foxtel supporting submission to revised Undertaking at page 26

¹⁷ Foxtel supporting submission at page 27

‘active declared service’ is that the service only encompasses those locations where Foxtel currently supplies services to end-users. As such, Foxtel cannot be forced to supply the service to non-Foxtel subscriber homes.

In contrast, Seven Network submits that the tying clause is not consistent with the SAOs. Seven Network contends that the effect of s.152AR(3)(a) is that if an access seeker requests the service in respect of a particular end user, Foxtel is required to provide that service irrespective of whether or not the end user is a Foxtel subscriber and irrespective of whether providing such a service requires Foxtel to install a STU at the end-user’s address.

The Commission’s preliminary view is that it has difficulty accepting the arguments advanced by both Foxtel and Seven Network Ltd as raised in relation to the October 2005 Undertaking.

The Commission is not convinced that the obligation to supply the declared service under s.152AR(3)(a) imparts an obligation on Foxtel to supply the service, irrespective of whether the end-user is a Foxtel subscriber or not. Similarly, the Commission does not accept that there can be no active declared service in respect of locations where Foxtel has no commercial agreement with a subscriber.¹⁸

The Commission’s preliminary view is that consistency with the standard access obligation to supply the declared service imposes only a basic requirement to supply a declared service. The primary question is whether the Undertaking obliges Foxtel to supply the declared service. On the question of whether Foxtel supplies the declared service, this depends on what is considered to be the declared service. The Commission’s preliminary view is that the tying clause is not properly characterised as a limitation by which the declared service should be defined.¹⁹ As such, the “deemed” declared service in this case is the Digital Set Top Unit Service to all potential subscribers rather than services only to Foxtel subscriber homes (ie. the tied service).

The Commission must then consider whether the terms of the Undertaking provide for the supply of the declared service. The preliminary view is that it does, in that it is essentially an undertaking to supply the Digital Set Top Unit Service. However, a feature or term of the Undertaking is that Foxtel is only prepared to supply the service to Foxtel subscribers homes.

The tying clause can be seen in the same context as the many other terms and conditions of supply contained within the Undertaking, the tying clause being but one of them. Accordingly, on this analysis, the Commission believes that the Undertaking meets the basic requirement of supplying the declared service, but a term of supply of this particular undertaking is that the service will only be supplied to Foxtel subscriber homes.

The Commission is of the preliminary view that the tying clause would be consistent with the obligation to supply the service in that the Undertaking does require Foxtel to supply the declared service albeit on particular specified terms. Whether or not those

¹⁸ See pages 146-148 of the Draft Decision

¹⁹ Section 152AL(7) provides that if the undertaking is subject to limitations, the service supplied by the person is a declared service only to the extent to which the service falls within the scope of the limitations.

particular terms of supply are appropriate in the Undertaking is, however, a matter that goes to the reasonableness of the Undertaking rather than the issue of consistency.²⁰

In this regard, the Commission's Draft Decision noted that while the tying clause may limit competition in the provision of digital subscription television services by increasing barriers to entry, Foxtel should not be required to supply STUs to homes to non-Foxtel homes.²¹

The Tribunal had expressed concern about similar tying provisions in *Seven Network Limited (No 4) [2004] ACompT 11*:

...we consider that the tie of the Basic Package to access to FOXTEL's services as contained in the digital access agreement is a significant deterrent to entry. This is exacerbated by what we regard as an unnecessary prevention of an access seeker using FOXTEL's infrastructure and services, other than its STUs, to deliver subscription television services. In our view, potential access seekers are likely to be deterred from commencing supplying subscription television services in competition with FOXTEL for so long as access is tied in this manner.²²

However the Tribunal continued:

...we are uncomfortable with the proposition that FOXTEL should be required to provide equipment at the behest of an access seeker, whilst receiving no immediate benefit itself (other than access fees), even if, as submitted by Seven Network, it was possible to ensure there was appropriate compensation. This notion also appears to depart from standard situations in which access is required.²³

The Draft Decision noted that while the tie serves to raise access seekers' costs and thus the price of obtaining an access seeker's channels by the cost of the basic package, it also noted the Tribunal's concerns about an alternative scenario in which Foxtel was required to supply STUs to homes not actually receiving its retail pay TV services. In considering this potential deterrent to entry, the Draft Decision also noted that any potential deterrent may be reducing over time. In May 2006 Foxtel altered the packaging and pricing of its Basic Package digital subscription television service to reduce the price of the Basic Package from \$50.95 per month to \$36.95 per month.

More generally, as suggested by the Tribunal in that case, the Commission looked further into the question as to whether Foxtel's infrastructure and services, other than its STUs, constitute a bottleneck element in the supply of subscription services. In particular, the Tribunal was concerned about access to Foxtel's conditional access/service information (CA/SI) services. Having had the advantage of receiving submissions on the matter, the Commission came to the view in the Draft Decision that they do not constitute a bottleneck. For competing full package providers who have access to a compelling suite of channels and carriage, there would appear to be no impediments to purchase and deployment of their own CA/SI functionality for

²⁰ At some point of course, a clause limiting supply can be so extreme as to effectively amount to a constructive refusal to supply and hence not be consistent with the SAOs. The Commission previously found that this is the case with respect to 'bundling' clauses in the original Undertaking, under which the limiting clause for the individual component services allows supply to no-one.

²¹ See pages 86-89 of the Draft Decision

²² *Seven Network Limited (No 4) [2004] ACompT 11* (23 December 2004) [301].

²³ *Seven Network Limited (No 4) [2004] ACompT 11* (23 December 2004) [295].

provision of subscription television services to end-users. This is evidenced by the fact that a number of competing subscription television service providers in Australia such as Optus, TransACT, and SelecTV currently supply their own STUs and CA/SI systems in order to serve their own subscribers. The Commission understands that a variety of CA/SI systems and hosting solutions can be readily purchased from third party suppliers. This would suggest CA/SI services are contestable inputs, and not bottleneck elements in the supply of subscription television services, *per se*.

The Commission notes that other factors such as access to carriage and/or access to compelling content may be impediments to effective competition between full package providers. These matters though are not directly relevant to the assessment of the Undertaking. A firm with sufficient access to premium content and carriage to provide a full retail Pay TV service will be able to buy CA and SI services on the open market.

Taking into account the various matters under s.152AH, including the legitimate business interests of Foxtel and interests of access seekers, the Commission's Draft Decision concurred with the Tribunal's view that Foxtel should not be required to supply STUs to non-Foxtel homes.

Overall view on whether the terms in the Undertaking are consistent with section 152AR(3)(a)

The Commission's preliminary view is that it is satisfied that the terms and conditions specified in the revised Undertaking are consistent with the applicable SAOs to the extent that those obligations would apply to Foxtel if the relevant service(s) were treated as declared service(s) as is required by s.152CBD(2)(a).

Reasonableness of terms and conditions

As noted above, the Commission's Draft Decision noted that it was satisfied that the terms and conditions specified in the October 2005 Undertaking were reasonable as required by s.152CBD(2)(b).

However, the Commission had some minor concerns about the non-price provisions in relation to indemnities and liabilities, and the access provider's ability to change the terms of the DAA. Similarly, while the Commission took the view that, overall, the price terms and conditions would promote the long-term interests of end-users, it noted that it would prefer to have more information about the cost base that Foxtel has used in calculating the IBAC and the marketing costs to be included in future periods as part of its pricing methodology.

In terms of the amendments to non-price provisions in the Undertaking in relation to indemnities and liabilities, and the access provider's ability to change the terms of the DAA, the Commission's preliminary view is that these changes function to reach a better balance between the legitimate business interests of Foxtel and access seekers. The amendments to terms and conditions relating to charges for fault repairs and EPG services were previously assessed by the Commission in its Draft Decision on the October 2005 Undertaking.

In relation to marketing costs included in the IBAC, the Commission notes that the Foxtel has not been able to provide a more robust measure of Foxtel-specific

marketing costs in response to the Commission's concerns.²⁴ While the Commission still has some concerns about a budgeted, single year figure being used for calculating the marketing costs included in the IBAC, it notes Foxtel's submission that it would be very difficult to provide that information. It also notes that additional information provided by Foxtel in its Submission suggests that the overall the impact of marketing costs on the total IBAC amount and the resultant access price is likely to be very small.²⁵

In relation to non-Foxtel-specific marketing costs to be included in future access prices, the Commission notes that Schedule 3 of the DAA has been amended to exclude marketing devoted to a single Subscription Television Service on Foxtel's tier from 'non-branded' marketing costs.

Delineating the scope of marketing costs that should be categorised as non-Foxtel-specific marketing costs will necessarily be a matter of judgement. In this regard, the Commission notes Foxtel's submission that it does not conduct a wholesale business and thus does not engage in any wholesale marketing of the Digital Set Top Unit Service to potential access seekers.

While the primary purpose of Foxtel's marketing expenditures will be to promote its retail subscription TV service, the effect of these activities is also the proliferation of STUs in customer homes. Under the terms of the Undertaking, such activity has the effect of maintaining and/or increasing the addressable market for access seekers. Therefore, the Commission considers that it is appropriate for access seekers that derive a benefit from the marketing activities of Foxtel to bear some degree of these costs.

Foxtel's revised approach means that marketing directed to a specific Foxtel channel in the Foxtel tier (which may compete with an access seeker's channel) will be excluded from the marketing costs used to calculate the access charge. While the costs of marketing packages of tiers (eg. the sports tier and the movie tiers) will be included as non-Foxtel-specific marketing costs, the Commission notes Foxtel's arguments that these tiers are likely to function as a significant driver of customer acquisition and retention. In this regard, the Commission notes Foxtel's submission that only [C-I-C] per cent of Foxtel's customers acquire only the basic package as part of their subscription.²⁶

In light of the amendments and additional supporting information put forth by Foxtel, the Commission is satisfied with the proposed scope and scale of marketing costs used for calculating the IBAC and access prices in future periods as part of Foxtel's pricing methodology.

The Commission also notes the amendment made by Foxtel in its revised Undertaking specifying independent periodic reviews of future marketing costs in conjunction with the review of Foxtel's rate cards.

In summary, the Commission's preliminary view is that the above amendments to the price and non-price terms and conditions satisfactorily address the relevant concerns

²⁴ Foxtel supporting submission at page 8.

²⁵ Refer to attachments to Foxtel supporting submission: A statement of Michelle Kvello and MK1 to the statement of Michelle Kvello.

²⁶ Refer to Confidential Appendix B of Foxtel's supporting submission.

noted in the Commission's Draft Decision and as such enhance the reasonableness of the Undertaking as a whole.

Therefore, the Commission's preliminary view is that it is satisfied that the terms and conditions specified in the revised Undertaking are reasonable as required by s.152CBD(2)(b).

Conclusion

Following from the above analysis and the reasoning expressed in its previous Draft Decision :

- the Commission's preliminary view – subject to public consultation – is that it is satisfied that the terms and conditions specified in the Undertaking are consistent with the applicable SAOs to the extent that those obligations would apply to Foxtel if the relevant service(s) were treated as declared service(s) as is required by s.152CBD(2)(a); and
- the Commission's preliminary view – subject to public consultation – is that it is satisfied that the terms and conditions specified in the Undertaking are reasonable as required by s.152CBD(2)(b).

As a result, the Commission's preliminary view is to accept the Undertaking. It now seeks submissions in response to this preliminary view.

Questions for submitters:

The Commission invites written submissions from interested parties on the following issues:

- The proposed amendments in Undertaking
- The Commission's preliminary views on these amendments
- The Commission's preliminary view on whether to accept or reject the Undertaking