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Declaration of an analogue subscription television broadcast carriage service

A report on an inquiry into the declaration of an analogue-specific subscription television broadcast carriage service under Part XIC of the *Trade Practices Act 1974*

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Summary

On 23 December 1998 the Australian Competition and Consumer Commission began a public inquiry into whether to declare, under Part XIC of the *Trade Practices Act 1974*, a particular service described as an 'analogue-specific subscription television broadband carriage service'.[1] The inquiry involved only a service delivered over the line links.

Once a service is declared a carrier or carriage service provider supplying the service to itself or another person must supply the service, upon request, to other service providers. Service providers are thus guaranteed access to the inputs they need in order to supply competitive communications services to end-users.

Terms and conditions of supply then can be set through commercial negotiation. Alternatively, they can be set by reference to regulatory processes which apply once a service is declared: in accordance with an access undertaking accepted by the Commission, or through arbitration by the Commission in the event that it is notified of an access dispute.

The Commission can make a declaration where satisfied it would promote the long-term interests of end-users. In considering the impact of declaration on end-users, the Commission must have regard to the impact of declaration on competition, any-to-any connectivity and economic efficiency.

To stimulate discussion and assist its consideration of these matters during the inquiries, the Commission issued a discussion paper in December 1998 setting out the main issues, reviewed submissions and discussed specific issues with economic, legal and industry experts.

In June 1999 the Commission issued a draft report which concluded that declaration of the service would promote the long term interests of end-users.

Following consideration of the information received in the inquiry, the Commission proposes to declare an analogue-specific subscription television service limited to line links.

The Commission expects that declaration will influence the development of competition for subscription television services, primarily in those areas where a subscription television service using line links is currently operating.

1 At the same time, the Commission initiated an inquiry into declaration of a 'technology-neutral' subscription television broadband carriage service. The Commission's decision not to declare this service is set out in a separate report: Declaration of Technology Neutral Subscription Broadcast Carriage Service.

Declaration of the subscription television service enables service providers to reach end users in order to deliver a wider range of services than currently available, and reduces the need for full duplication of communications networks.

The Commission expects that declaration of subscription television services will promote competition and provide end-users with the ability to choose between different suppliers of subscription television program packages, particularly in areas of niche programming.

This report describes the service that the Commission proposes to declare, along with the Commission's reasoning. It is structured as follows:

Section 2 outlines the access regime and relevant provisions governing the declaration process, including details of the public inquiry. Appendix 2 contains a list of the companies and entities that made submissions.

Section 3 sets out the characteristics of the service that has been developed by the Commission. The initial service descriptions are contained in Appendix 1. The revised service description may be found in Appendix 3.

Sections 4, 5 and 6 set out the Commission's reasoning as to whether declaration of these services will promote the long-term interests of end-users.

Section 7 presents the Commission's conclusions.

The Commission will, following publication of this report, execute the declaration instruments and publish them in the Commonwealth Gazette.

The declaration process

Part XIC of the Act establishes an industry-specific regime for regulated access to carriage services. The regime provides for the Commission to declare carriage services and services which facilitate the supply of carriage services (i.e. eligible services). The Commission makes its decisions in the context of the primary object of Part XIC, which is to promote the long-term interests of end-users.

Declaration and regulated access

There is no general right of access to eligible services. The rights and obligations under Part XIC apply only in respect of those services which are declared by the Commission.

The declaration decision is, in essence, a decision by the Commission to apply the rules and regulatory processes in Part XIC to the eligible services covered by the declaration. Once an eligible service is declared, carriers and carriage service providers which provide the service either to themselves or to other persons are, unless otherwise exempt, required to comply with standard access obligations in relation to the service. In accordance with these obligations, the carrier or carriage service provider (i.e. the access provider) must supply the service on such terms and conditions as are agreed with a service provider seeking access (i.e. the access seeker), or failing agreement, in accordance with an access undertaking accepted by the Commission or an arbitration determination of the Commission.

The emphasis of Part XIC is on encouraging access providers and access seekers to negotiate access to declared services without recourse to further regulatory intervention. In this regard, Part XIC provides for the industry to establish an access code and for access providers to give access undertakings to the Commission setting out the terms and conditions of access. However, where the parties are unable to reach agreement on the terms and conditions of access, the Commission can conduct arbitration upon request from one of the parties.

How eligible services are declared

To ensure a smooth transition from the previous regulatory regime, an initial list of eligible services were deemed to be declared services under Part XIC. These services were specified in the Commission's *Deeming of Telecommunications Services* statement published on 30 June 1997. They were generally derived from agreements registered under the Telecommunications Act 1991.

Under Part XIC the Commission can declare other eligible services in one of two ways, namely:

- in accordance with a recommendation of the Telecommunications Access Forum; or
- after holding a public inquiry, if it is satisfied that making the declaration will promote the long-term interests of the end-users of carriage services or services provided by means of carriage services.

Inquiries

Section 39(5) of the *Telecommunications (Transitional Provisions and Consequential Amendments) Act 1997* (Transitional Act) required the Commission to deem a service that is 'necessary for the purposes of enabling the supply of a broadcasting service by means of line links that deliver signals to end-users.'

On 30 June 1997 the Commission deemed the broadcasting access service to be a declared service under the Transitional Act. In the deeming statement, the Commission described this service as follows:

> An analogue service necessary for the purposes of enabling the supply of a broadcasting service by means of line links that deliver signals to end-users, and of a kind that was used for those purposes on 13 September 1996. This is an access service that provides a basic carriage and distribution access function together with other functions as requested.

As stated in the discussion papers, the precise wording of the present service description allows access seekers to choose which services are covered by the declaration. Because of this, concerns have been raised with the Commission about the validity of the declaration.

The Commission considers that the existing service declaration is valid. However, in order to provide certainty, the Commission commenced inquiries into whether to declare 'analogue-specific subscription television broadband carriage services' and 'technology-neutral subscription television broadband carriage services'.

The analogue-specific and technology-neutral inquiries, governed by Part 25 of the *Telecommunications Act 1997*, were announced on 23 December 1998. The Commission released a discussion paper for each inquiry outlining particular issues and calling for submissions. In response, submissions were received from 14 organisations. A list of those companies and entities that made submissions are in Appendix 2.

In June 1999 the Commission released a draft report in which it concluded that declaration of the analogue-specific service would promote the long-term interests of end users.

Existing declaration

Telstra has argued that, given the Commission considers the original declaration is valid, it can only justify declaration of the proposed service if that would promote the long-term interests of end-users more than the original.

The Commission considers that the greater certainty provided by the proposed declaration would promote competition beyond the level that could be expected under the existing declaration. Although the Commission considers the existing declaration to be valid, it considers that access seekers may be reluctant to seek to enforce their rights under it while there is uncertainty in the industry as to its validity. The Commission considers it unlikely that the advantages which might otherwise arise from increased competition would be realised in these circumstances.

The Commission considers that there is no legal impediment to it declaring the proposed service while the existing one is in force. However, it would be concerned at any confusion which arose because of the existence of two declarations covering similar services. Given that the declarations are likely to overlap, the Commission intends to hold a public inquiry under Part 25 of the Telecommunications Act to consider revocation of the existing declaration.

Some submissions have argued that proper public consultation under Part XIC of the Act is not possible while the status of the existing service is uncertain. The Commission considers that it has met its statutory obligations under Part XIC in relation to holding public inquiries.

The long-term interests of end-users test and its application

Section 152AB of the Act provides that, in determining whether end-users' long-term interests will be promoted by declaring an eligible service, the Commission must consider the following objectives:

- promoting competition in markets for carriage services and services supplied by means of carriage services;
- achieving any-to-any connectivity for carriage services involving communication between end-users; and
- encouraging the economically efficient use of, and economically efficient investment in, the infrastructure by which carriage services and services provided by means of carriage services are supplied.

The Commission will only have regard to these matters in determining whether declaration promotes the long-term interests of end-users. However, in the Commission's view these objectives are essentially 'secondary objectives'. They are not ends in themselves but are the means by which the primary objective (of promoting the long-term interests of end-users) is to be realised.[2]

Where declaration is likely to result in the achievement of one or more of these objectives, it will generally promote the long-term interests of end-users. For instance, if declaration is likely to promote competition in a market for the supply of local telephony services to end-users, then end-users are likely to benefit through lower prices and improved customer service. Similarly, encouraging efficient investment would be expected to promote end-users' interests through enhancing the efficiency with which telecommunications services are supplied. The enhanced efficiency would be generally reflected in lower prices. The Commission may also conclude that efficient investment will be likely to increase service diversity.

With respect to any-to-any connectivity, the Commission takes the view that the achievement of this objective will generally benefit end-users by facilitating increased

2 See *A Guide to the ACCC's Administration of the Declaration Provisions of Part XIC of the Trade Practices Act 1974,* July 1999.

communication between them. Any-to-any connectivity may also facilitate competition by ensuring that, when migrating between service providers, end-users do not lose their ability to communicate with other end-users.

The approach adopted by the Commission will generally involve case-by-case analysis to form a view about the likely result of declaration on the achievement of each secondary objective. This not only ensures that the Commission considers the impact of declaration in terms of each objective, but also helps it to reach a decision in terms of the overall effect on the long-term interests of end-users where declaration is likely to have mixed effects.

The analytical process used by the Commission generally involves three steps.

- First, it considers the likely result of declaration in terms of each secondary objective.
- Second, it considers whether the likely result of declaration on each secondary objective will promote the long-term interests of end-users.
- Third, it must make an overall assessment of whether, having regard to the cumulative results of declaration on the secondary objectives, declaration will promote the long-term interests of end-users.

In some cases, this three stage analysis may be undertaken as discrete steps whereas in others it may be appropriate to undertake the analysis simultaneously. For instance, in considering the likely result of declaration on competition, it may be useful to consider the impact in terms of price, quality and diversity of services supplied to end-users.

To consider the likely result of declaration on a secondary objective, the Commission finds it helpful to use a ‘with and without test’. That is, it considers the future without declaration and compares this to the future with declaration. This ‘with and without test’ is not a test in its own right but is used to isolate the effects which are likely to occur as a result of declaration. Moreover, given that many aspects of the future will be speculative, the Commission may not be able to describe the future in a high degree of detail, or determine the full range of possible scenarios. The Commission will seek to examine those aspects of the future (primarily competition and efficiency considerations) which have a direct bearing on the issues before it.

Further details on the Commission’s approach to applying the long-term interests of end-users test are set out in *A guide to the Commission’s Administration of the Declaration Provisions of Part XIC of the Trade Practices Act 1974*, which is available on the Commission’s website http://www.accc.gov.au.

Industry maturity

Some submissions have argued that the ‘future with-and-without’ test is inappropriate in an ‘immature industry’ such as the retail pay TV industry.

The Commission does not accept this contention for a number of reasons.

- In the relatively short time since pay TV services began in Australia in January 1995, over 900 000 television households in Australia have subscribed to pay TV. National total pay TV penetration in Australia is 15 per cent, while national cable penetration is 9.5 per cent. Forty-five per cent of homes are passed by cable.[3] The penetration rate after three years was about 4 per cent in the UK and about 10 per cent in NZ.[4]
- The fact that there may be rapid changes in communications technology does not necessarily make it inappropriate to draw reasonable inferences about the future of industries or markets, particularly in industries such as the pay TV industry where there are established economic imperatives such as the high cost of building carriage infrastructure.
- The Commission considers that the effect of the introduction of digital services is not yet sufficiently clear to regulate such services through Part XIC of the Act. While such services will ultimately have an effect on the pay TV industry as a whole, this may not happen for some years. The Commission will continue to monitor and review the impact of digital services on subscription television.
- The Commission, as the general competition regulator, has already intervened on a number of occasions in the pay TV industry.[5]
- At an international level, the retail pay TV industry is not an immature industry. In the United States, for example, from the mid-1970s the cable pay TV industry developed rapidly with the removal of restrictive regulations and the advent of new technology so that, after around 25 years, cable now passes over 96 per cent of US television households, of which over 67 per cent subscribe to cable television services (the penetration rate).[6] Overseas experience should be used with caution in anticipating developments in Australia, because of different regulatory environments and market characteristics. There are nonetheless some similarities which assist in anticipating how a mature industry would develop in Australia.
- Legislators and regulators in overseas countries have intervened on competition grounds in the pay TV industry in markets of varying maturity. For example, the European Commission's 1995 Directive on Advanced Television Standards required operators of conditional access services to offer access to those services on fair, reasonable and non-discriminatory terms. This is progressively being enacted into national law.[7] In the UK, British Telecom was prohibited from providing broadcast entertainment services from the outset of the introduction of subscription television.

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3 Figures quoted in Foxtel submission of 30 June 99.

4 From reported comments by Mr Tom Mockridge, Chief Executive of Foxtel, in 'The Guide' in *The Sydney Morning Herald*, p. 4, February 22–28, 1999.

5 For example, the institution of Federal Court proceedings against the proposed merger of Foxtel and Australis (No. NG 851 of 1997).

6 Paul Kagan Associates, Inc, 'Marketing — New Media', 16 November 1998.

7 Council Directive 95/47 on the use of standards for the transmission of television signals.

The services

The Commission's declaration decision must be framed in terms of one or more 'specified eligible services'.[8] It is these eligible services to which the standard access obligations in Part XIC of the Act apply and, accordingly, it is important that they be correctly specified. Too narrow a specification may unnecessarily limit the services that the access provider must supply to access seekers. On the other hand, too broad a specification may lead to uncertainty and have undesirable consequences in terms of innovation and investment.

Eligible service — wholesale carriage

Description

The eligible service proposed for declaration is fundamentally a service which carries pay TV services over broadband cable networks using analogue transmission technology (hereafter generically referred to as 'analogue pay TV cable carriage services'). This service essentially involves the following elements:

- receipt by the carrier of a pay TV service in the form of a sequence of video, audio and related signals;
- modulation and encryption of the signals for analogue transmission over the carrier's cable network;
- carriage of the signals over the carrier's cable network;
- demodulation and decryption of the signals in the end-users' conditional access equipment.

The 'technology-neutral subscription television broadband carriage service'

In general terms, the Commission's preference is to specify services in functional, rather than technology-specific, terms. The Commission sought submissions on two types of services described in its discussion papers as an 'analogue subscription television broadband carriage service' and a 'technology-neutral subscription television broadband carriage service'. Each service description also had a 'network management service' relating to conditional access and subscriber management functions. The services are inputs into the provision of retail subscription television services, although it is possible that each could be used for the provision of other services. Appendix 1 contains the service descriptions attached to the discussion papers.

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8 Section 152AL(3) of the Act.

The Commission initiated the inquiry into declaration of a ‘technology neutral subscription television broadband carriage service’ with a view to accommodating changing technology for providing broadcasting access. In particular, it was anticipated that such a declaration would cover digital services.

The Commission has reached the conclusion that it would be premature to declare a ‘technology neutral subscription television broadband carriage service’. The Commission has reported separately on its decision with regard to this service.[9]

Satellite subscription broadcasting services are digital to the set-top unit. Commercial and national free-to-air broadcasters will be required to begin digital terrestrial television broadcasting (DTTB) in metropolitan areas by 1 January 2001 and in regional areas from that date onwards so that they have DTTB by 1 January 2004.

The Commission notes that there are no digital broadcasting services currently being delivered to end-users over line links in Australia. Nor is there a firm timetable for the deployment of such services. The likely rate of adoption of DTTB equipment by consumers, and the types of services that will be available using DTTB, are difficult to assess at this stage.[10]

Some submissions have stated that deployment of digital services over line links is technically and commercially feasible. While the Commission would prefer to declare a technology-neutral service, it has formed the view that there is not sufficient evidence that declaration would promote the long-term interests of end-users in advance of the deployment of digital services on a reasonable scale here and overseas.

Degree of unbundling and standard access obligations

In developing appropriate service descriptions, the Commission considered whether to prepare descriptions for individual elements or whether to bundle particular elements together. Unbundling services completely to their component elements ensures that access seekers need only acquire the individual elements which they want, but has the potential to increase costs for the access provider.

Access seekers provided a range of models in their submissions. These ranged from a service which consisted purely of carriage of broadcasting signals to a bundled or ‘integrated’ service which consisted of carriage, modulation and demodulation, encryption and decryption, installation and maintenance of set-top units, marketing, billing and revenue collection.

A number of submissions criticised the Commission’s draft report for favouring a model of ‘direct access’ to customers, in which access seekers had a direct retail relationship with the customer. The Commission does not favour any model in

9 *Report on Declaration of a Technology Neutral Subscription Television Broadcast Service*, Australian Competition and Consumer Commission, August 1999.

10 Reviews are currently under way into the types of programming commercial and national broadcasters will be able to provide via their digital services.

particular. The service description, when combined with the access obligations in Part XIC, allows access seekers some flexibility in whether they acquire a bundled or an unbundled service. Direct access to customers is possible, under the declaration, if access seekers wish to provide services in this manner, but it is not mandatory.

In addition to the carriage service element, the Commission considered a Network Management Service that included conditioning of customer access equipment and maintaining a database of end-users. After considering submissions, the Commission considers that the standard access obligations imposed on access providers by s. 152AR cover services ancillary to the carriage of pay television signals sufficiently to enable service providers to supply pay television content, if they obtain access to the proposed declared service. It is therefore considered unnecessary to declare the Network Management Service (included at Attachment B to the service description proposed in the Commission's discussion paper).

Of the services that together make up a subscription television service, the Commission considers that carriage, modulation and demodulation, encryption and decryption, installation and maintenance of set-top units would either fall under the Standard Access Obligations or be matters about which the Commission could make an arbitral determination under Division 8 of Part XIC. Access seekers are free to negotiate for the access provider to provide additional elements such as sales and marketing support, or retail services such as billing and revenue collection. Access seekers are not obliged to accept such services if they do not require them, and access providers are not obliged to provide them.

To ensure that deletion of the Network Management Service did not have the unintended consequence that the service description would operate to allow access seekers to have their programming carried only to existing pay television subscribers, it was necessary to amend the description of the carriage service (Annexure A of the service description included in the discussion paper). In particular, the service description was amended to apply to both the carriage of signals to the conditional access customer equipment of existing subscribers and also to potential points of interconnection with the access provider's cable network (to allow access seekers to connect up households that are not currently subscribers in order that the cable network can be used to deliver content to them). The Commission intends that there should be an obligation upon access providers to provide access to a service that includes conditional access functions performed by set-top units, where these are required by access seekers. The service description has been amended to make this clear.

The revised service description is at Appendix 3.

Submissions have raised questions about whether an access provider who provides a carriage service to a set-top unit, but who does not own the set-top unit, could be required to provide access to the set-top unit. The Commission considers that, to the extent that access providers exercise control over set-top units, they will be required by the standard access obligations to supply access to the units.

Inclusion of non-Telstra and non-Cable & Wireless Optus cable infrastructure

The Commission prefers that the service description not specify the identity of the access provider. In the Commission's view, this approach best reflects the intent of the legislation which has included a special process for exempting particular access providers from the statutory consequences of declaration — s. 152AT of the Trade Practices Act.

In relation to the exemption process, the explanatory memorandum states:

> This mechanism could be used in circumstances where infrastructure investments of national or regional significance are proposed which would provide long-term and substantial benefits to end-users or carriage services and services supplied by means of carriage services, but would not proceed or would be severely hampered if the standard access obligations applied in their entirety. The provision is drafted in broad terms because Commission judgments about the giving of an exemption and the precise nature of exemptions given need to be made on a case-by-case basis.[11]

Under s. 152AT, an access provider can apply to the Commission for an exemption from the standard access obligations. The Commission can grant an exemption where it is satisfied that to do so would promote the long-term interests of end-users of carriage services or of services provided by means of carriage services.

11 Explanatory memorandum for the Trade Practices Amendment (Telecommunications) Bill 1996 – clause note for s. 152AT.

Promoting competition

In considering how declaration of particular eligible services might promote the long-term interests of end-users, the Commission must consider whether declaration is likely to promote competition in markets for particular services — namely, markets for carriage services or services supplied by means of carriage services.

In general, declaration of an eligible service is likely to promote competition where:

- the eligible service is an input used for the supply of carriage services or services provided by means of carriage services; and
- the supplier (or suppliers) of the eligible service has (or have) substantial market power which can be used to influence competition between suppliers of carriage services or services provided by means of carriage services.

This is because declaration constrains the ability of the supplier of the eligible service to exercise market power in respect of the supply conditions. This constraint on market power may enable more efficient competitors to enter markets for carriage services or services supplied by means of carriage services, win custom from less efficient competitors, and thereby promote competition in those markets.

These are not the only circumstances in which declaration is likely to promote competition.

To examine whether declaration would be likely to promote competition, often it will be appropriate for the Commission to consider the market in which the eligible service is or would be supplied in addition to the market in which competition would be promoted (where these are separate markets).

Market definition principles

Identification of the relevant markets provides the Commission with a field within which it can meaningfully analyse the effectiveness of competition with and without declaration.

Markets involve four dimensions: product, geography, function and time. The process of market definition involves identifying the sellers and buyers which effectively constrain the price and output decisions of firms supplying the service(s) under consideration.

To begin the market definition process it is necessary to identify the service under consideration and the firm(s) supplying that service. For instance, if the Commission wanted to identify the market in which the eligible service is (or would be) supplied, the market definition process would start with the access provider and its supply of the eligible service. If, instead, the Commission wanted to identify the downstream markets in which declaration might promote competition, the market definition process would start with access seekers and the downstream services that they would supply using the eligible service.

Once the relevant service and source(s) of supply have been identified, they are then described in terms of the product, geographic and functional area of supply. The market boundaries are then extended to include all other sources and potential sources of close substitutes with which the firm supplying the service would compete. In terms of s. 4E of the Act:

> ... ‘market’ means a market in Australia and, when used in relation to any goods or services, includes a market for those goods or services and other goods or services that are substitutable for, or otherwise competitive with, the first-mentioned goods or services.

As noted by the High Court:

> This process of defining a market by substitution involves both including products which compete with the defendant’s and excluding those which because of differentiating characteristics do not compete.[12]

To identify services that are ‘substitutable for, or otherwise competitive with’ the services under consideration, the Commission uses the ‘price elevation test’. The resulting market is the smallest area over which a profit maximising monopolist could impose a small but significant and non-transitory price increase. In addition, the Commission takes account of ‘commercial reality’ to ensure that the market which it identifies accurately reflects the arena of competition.[13]

The availability of close substitutes (on both the demand and supply sides) constrains the ability of suppliers to profitably divert prices or quality of service from competitive levels. Generally, a greater range of substitutes points to a broader market in which individual participants have less power, and consequently competition is more effective.

In identifying relevant markets, Part XIC does not require the Commission to take a definitive stance on market definition. Furthermore, over time, declaration itself might affect the dimensions of these markets, particularly in relation to the functional dimension. Accordingly, market analysis under Part XIC should be seen in the context of shedding light on how declaration would promote competition rather than in the context of developing ‘all purpose’ market definitions.

The Commission is aware of four cable networks which are currently used to deliver pay TV services to subscribers in Australia:

- the Telstra Multimedia network, which passes around 2.5 million households in Sydney, Melbourne, Brisbane, the Gold Coast, Adelaide and Perth;
- the Cable & Wireless Optus (C&W Optus) network, which passes around 2.2 million households in Sydney, Melbourne, Brisbane and Adelaide;
- the Austar network, which passes around 20 000 households in Darwin; and

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12 *Queensland Wire Industries Pty Ltd v. BHP Ltd* (1989) ATPR ¶40-925, p. 50, 008 per Mason CJ and Wilson J.

13 See, for instance, paragraphs 5.49 and 5.66 of the Commission’s *Merger guidelines*, June 1999.

- the Neighborhood Cable network, which passes around 8000 households in Mildura.

The Commission understands that the roll-outs of the Telstra and C&W Optus networks have been in abeyance since late 1997. The Austar network in Darwin is still being rolled-out and is expected to be completed later this year and pass a total of 29 000 homes. The Neighborhood Cable network continues to be rolled-out in Mildura and the company has plans for roll-outs in other regional centres.

The Commission is also aware of other planned cable network roll-outs, including by:

- ACTEW, an electricity and water utility which has constructed a pilot network in Canberra and is currently conducting trials; depending on the technical and economic success of the trial, ACTEW plans a Canberra-wide deployment commencing later this year; and

- NorthPower, an electricity utility which is in the final stages of developing a business case for a network in northern New South Wales.

Many of these cable networks, current and planned, are capable of transmitting, and intended to transmit, not only pay TV services but a range of other services such as telephony and on-line high-speed interactive services. Not all the networks, however, are currently used to deliver a full range of services.

Cable service providers function at the wholesale and retail level: they package, deliver, promote, bill and collect payment for subscription television channels provided to retail customers. The channels are usually provided as part of a package, or as an additional tier after retail consumers have subscribed to a basic package.

Relevant market

Identification of the relevant market in which analogue pay TV cable carriage services are supplied involves an analysis of actual or potential close substitutes to these services. The Commission looks to substitution possibilities on both the demand and supply side, both in the product and geographic dimensions.

The product dimension

A number of means may be used to carry or deliver pay TV to subscribers, including cable networks, satellite, multipoint distribution systems (MDS), the broadcasting services bands of the radiofrequency spectrum (e.g. VHF and UHF) and, potentially, xDSL technology utilising the existing twisted-pair copper telephone lines.

Only cable, satellite and MDS are currently used in Australia to deliver pay TV services. While the digital conversion of free-to-air television broadcasting from 1 January 2001 has the potential to open up the 7MHz bandwidth to multiple channels, use of this spectrum for multichannelling is prohibited under *the Broadcasting Services Act 1992*.[14]

The potential for future deployment of xDSL services has been noted by the Commission in its decision on the declaration of local services.[15] However, information gathered during the inquiry into local services suggests that, in the short to medium term, service providers hoping to use xDSL services will focus on data and Internet services rather than subscription broadcasting.

The Commission considers that the picture reception quality of pay TV signals is broadly similar whether the signal is delivered by either cable, satellite or MDS. Furthermore, each technology is capable of delivering multi-channel services. However, each particular mode of delivery has certain advantages and disadvantages.

Where available, cable is generally considered by the pay TV industry as a superior means of delivering pay TV services because of its greater capacity and functionality.[16] The Commission understands that both the Telstra and C&W Optus networks are capable of transmitting around 64 analogue channels on the bandwidth reserved for pay TV. With digital transmission, this capacity can be greatly increased.

Cable offers greater potential for sophisticated interactive services. Some submissions stated that this is not relevant in considering the declaration of subscription television services. However, access seekers have submitted that, with greater convergence of services, the potential for interactive services will be attractive to consumers, and that other modes of delivery will be disadvantaged by lack of such a feature. The Commission considers that cable would derive some advantage from this perception although, in the shorter term, it is unlikely to be as significant as access seekers believe.

The Commission notes that, despite owning the satellite currently used to deliver pay TV services in Australia, C&W Optus has yet to offer its own satellite-delivered retail pay TV service.

However, cable is not available everywhere. The cable networks of C&W Optus and Telstra pass only around 2.5 million of Australia's 6.2 million television households. In this respect, satellite has advantages in having a broad national coverage.

14 Under paragraphs 7(1)(m) and (p) of Schedule 2 (commercial broadcasters), and clauses 35 and 36 of Schedule 4 (ABC and SBS), of the *Broadcasting Services Act 1992*. However, a review of the prohibition must be conducted by January 2006.

15 *Declaration of Local Telecommunications Services*, ACCC, Final Report, July 1999, pp 45–49.

16 For example, Austar on its web site (http://www.austar.com.au) describes the advantages and disadvantages of cable as follows:

> The main advantages of cable are: the potential for over 100 channels, the ability to support fully interactive services (internet and telephony) and a high degree of resistance to interference from other transmissions and the weather. The cost of cabling, however, is very high and roll-out is labour intensive and, therefore, slower than the other technologies.

About 95 per cent of Australia's population can be reached with small 65 cm dishes using high-powered transponders on C&W Optus B3, the only satellite currently used to deliver pay TV services in Australia. The satellite has 15 transponders, seven of which are high performance (HP) transponders capable of transmitting signals to the small dishes. With digital technology, each HP transponder can transmit around 10 channels. The Commission understands that this can be increased to around 19 with the use of statistical multiplexers.

Similar pay TV reach with small dishes can be achieved on the new PanAmSat-8 satellite, owned by PanAmSat. A number of other satellites are potentially available for pay TV carriage but generally they do not have HP beams focused on Australia. Wide-dispersion or low powered beams require more expensive larger dishes.

MDS transmission infrastructure has the advantage of being relatively cheap but it suffers from a need generally to have line-of-sight from the transmission tower (unless expensive 'beam benders' are used). Up to 19 video channels can be transmitted over the MDS frequencies in the analogue mode currently used. Increasingly, MDS frequencies are being used overseas for non-video purposes such as high-speed data transmissions.

The Commission considers that cable, satellite and MDS are close substitutes for delivery of pay TV services and, therefore, in the same wholesale market.

The geographic dimension

Geographic areas in Australia can be categorised according to supply-side characteristics.[17]

- Cabled areas — metropolitan areas passed by one or more cables, and/or within range of an MDS system, including:
  - dual-cabled metropolitan areas — around 2 million households in metropolitan Sydney, Melbourne, Brisbane and Adelaide are passed by both Telstra and C&W Optus cables (or about 80 per cent of cabled areas);
  - single-cabled metropolitan areas — around 500 000 metropolitan households are passed by one of Telstra, C&W Optus or Austar;
- Uncabled areas — metropolitan or regional areas served by satellite and/or MDS, with the prospect of entry by cable providers, including:
  - uncabled metropolitan areas — around 2 million households serviced by the Foxtel satellite service (including Newcastle, the NSW central coast, Canberra and Geelong); and
  - regional areas — around 1.7 million households generally serviced by Austar's satellite and MDS services (except the Foxtel satellite service which services regional Western Australia, and Neighborhood Cable which services Mildura in competition with Austar).

17 It should be noted that Television and Radio Broadcasting Services Australia provides a niche pay TV service to a small number of subscribers in six metropolitan cities using MDS.

In each of these geographic areas there is, on the demand-side, a different range of choices available for a pay TV service provider seeking access to carriage infrastructure. On the supply-side, substitution possibilities are limited in all four areas.[18]

In each of these geographic markets, the Commission considers that the likelihood of entry by alternative carriage providers would be different, as would the likely demand for such carriage services by retail pay TV services.

Effect on competition

In the absence of any collusive behaviour between suppliers of cable, satellite or MDS carriage infrastructure, one would expect that any market power arising from control of certain infrastructure would be offset by the availability of alternative infrastructure.

Competition in a market is very much a matter of the structure of a market: where the structure gives rise to market power, competition is hindered or prevented. The most important structural factor is generally recognised as the height of barriers to entry, for the threat of entry is often viewed as the ultimate regulator of competitive conduct. Other structural factors include the level of market concentration, the degree of import competition, the extent of vertical relationships and the nature of any horizontal arrangements between market participants.[19]

Foxtel submits that barriers to entry are not present in the wholesale carriage market. The Commission does not accept this contention.

Cable

In respect of cable entry, the economies of scale and high sunk and fixed cost requirements of cable investment are such as to limit entry by this means. In the event of a market already cabled, the barriers to entry would be significantly increased.

Both overseas and in Australia, there have been special factors allowing for the construction of cable networks capable of delivering pay TV. In the US, cable systems developed as monopoly cable franchises and also had the advantage of carrying the free-to-air signals of local broadcasters because of reception problems.

Competing systems have only recently emerged in the US. Cable overbuilds have been rolled-out on a limited scale by local telephone companies such as Ameritech and BellSouth offering bundled telephony and video but, generally, significant competition from telephone companies has not emerged. Satellite has emerged with around 14 per cent pay TV market share (10.4 million subscribers) but predictions vary about its continued growth, particularly given satellite’s lack of local broadcast signals and the

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18 In market definition analysis, supply-side substitution is distinguished from market entry. Unlike market entry, substitution does not require significant investment to change from supplying one type of service to another (for example, a satellite operator changing from a datacasting service to a pay TV carriage service).

19 Refer to the Commission’s *Merger Guidelines*, June 1999. Also refer to *Re Queensland Co-op Milling Association Ltd & Defiance Holdings Ltd* (1976) ATPR 40-012 at 17,246.

growth of digital cable TV which can match the large number of channels offered by satellite.[20] MDS provides competition to cable in only limited areas and subscriber numbers to MDS systems are actually declining.[21]

The emergence of regional cable systems in the UK has depended on the exploitation of economies of scope from bundling pay TV services and telecommunications services. However, they have a particular advantage in that the incumbent, British Telecom, is currently prohibited from offering pay TV services.[22]

In Australia, pay TV afforded C&W Optus the opportunity to roll-out a cable network. The funding of this network depended critically on multiple revenue streams and economies of scope. Without pay TV and the ability to bundle it with local telephony and other telecommunications services, it is considered most unlikely that the C&W Optus residential network would have been rolled-out.

One consequence of the C&W Optus roll-out was that Telstra substantially overbuilt the network as a defensive measure. The former Chief Executive of Telstra, Mr Frank Blount, has been reported as saying that '…the decision to go into pay TV was based on the need for Telstra to defend its telephony business after it learned C&W Optus was targeting its customers with a combined pay/telephony cable'[23].

The Commission considers that, without those special factors operating in Australia at the time, it is unlikely that such extensive cable networks would have been built. It is considered even more unlikely that additional broadband cable networks capable of delivering pay TV to residences will be constructed where there are already cable networks in place. The Commission considers that it would be particularly uneconomic if funding for the network were largely reliant on one revenue stream such as pay TV fees and subscriptions.

Furthermore, as pointed out in some submissions, C&W Optus and Telstra had an economic advantage in establishing their networks because at the time each was immune from town planning requirements. New networks must not only overcome the high sunk and fixed costs but also planning requirements not then faced by C&W Optus and Telstra.

In regional areas not currently served by cables for delivery of pay TV or broadband services, there is still a case for deployment of cable systems. The Commission notes the plans for cable roll outs by ACTEW and NorthPower. In each of these cases, the

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20 Paul Kagan, *op. cit.*

21 Refer generally Fifth Annual Report of the US Federal Communications Commission (FCC) in the matter of *Annual Assessment of the Status of Competition in Markets for the Delivery of Video Programming,* CS Docket No. 98–102, 23 December 1998.

22 Refer 'Regulating digital television in a convergent world', Martin Cave, *Telecommunications Policy,* Vol 21 No 7, 7 August 1997. In April 1998, the British Government announced that restrictions on British Telecom (and other similar operators) would be lifted from 2001.

23 Weekend Australian, 30 August 1997, p. 53.

case for deploying cable networks is linked with advantages derived from linkages with other utility services.

Multipoint distribution systems (MDS) and broadband wireless (LMDS)
The Commission understands that there are no spare MDS frequencies which can be used to provide a pay TV service, and that there are no current plans by the Government to make more frequencies available. In March 1999 the Australian Communications Authority issued a paper seeking views about options for future licensing of the MDS bands. Current MDS licensees, including those providing pay television services, are not guaranteed to have their licences renewed on expiry. Furthermore, as previously noted in respect of its video limitations, MDS is increasingly being used for non-video purposes.

Although additional broadband wireless (LMDS) spectrum may be made available, the Commission notes that AAPT, the successful bidder in the most recent auction for such spectrum, plans to use it for voice, data and Internet services rather than pay television.[24]

Television & Radio Broadcasting Services Australia (TARBS) is currently providing a pay television service via MDS, but because of its capacity and technical limitations it cannot provide effective competition to the cable systems.[25]

Satellite
While market entry has taken place, with a number of satellites currently offering carriage services (Optus, PanAmSat, Intelsat), service providers wishing to enter downstream markets have encountered difficulties in using such services.

Potential access providers have argued that satellite is a competitively priced delivery service which acts to constrain any possible market power exercised by cable owners.

C&W Optus, a potential competitor to Austar and Foxtel in the provision of retail pay television services, has entered into arrangements with both Austar and Foxtel to use its satellite delivery system.

Spare satellite capacity may be available on other satellites such as PanAmSat-8. However, potential access seekers have advised the Commission that there are significant economic difficulties for a pay TV service provider establishing a retail pay TV service using a different satellite platform from that of the market incumbents. The

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24 AAPT Successful In Acquiring LMDS Broadband Network Spectrum, AAPT News Release, 18 February 1999

25 For example, the Wireless Communications Association International, an American-based industry association notes on its website (www.wcai.com/How_it_works.htm) that:

> A more complex system configuration may be required *[for MMDS]* in an area with several hills. Such topography would result in 'shadowed' areas (e.g., areas where line-of-sight reception is blocked) if served by one transmitter. By strategically positioning several transmitters (signal booster stations) in the service area, the shadowed areas can be reduced.

There is also limited channel capacity compared to other means of delivery.

cost of digital satellite receivers is prohibitive for a niche operator where revenue potential from niche program offerings is limited. If a different satellite system is used, a new satellite entrant would be required to fund the cost of installing separate satellite reception equipment and dishes as well as a separate conditional access system. The cost would increase proportionally should larger dishes be required.

Fundamentally, Australia’s relatively small market of around 6.2 million television households would appear to make it difficult for a new entrant without premium programming to recoup the cost of a separate satellite pay TV platform.

The Commission is supported in this view by reported comments by the Chief Executive of C&W Optus, Mr Chris Anderson, that ‘…sharing satellite delivery infrastructure is a sensible decision for all parties. The establishment of a separate delivery platform would have been commercially irresponsible and not in the best interest of customers’.[26] These comments were made at the time Foxtel reached agreement in December 1998 on the leasing of transponder capacity from C&W Optus, and after Foxtel had been reportedly negotiating with PanAmSat. The agreement supports the view that economies of scale in satellite delivery are a major barrier to entry to downstream markets.

Access seekers argue that, even when they have acquired satellite capacity, it has not allowed them to compete effectively with cable.

For example, TARBS has entered into a commercial arrangement with PanAmSat, primarily to deliver its programming to its MDS headends in metropolitan areas. Potentially, this service could be used to deliver services directly to end users, but the cost of digital set-top units means this is not a commercially viable strategy (on any significant scale) at this stage. In addition, the availability, or potential availability, of a wider range of broadband services over cable is likely to be a competitive handicap for satellite in cabled areas. On the basis of costs provided by Foxtel and TARBS, the expense of an access seeker providing and connecting its own analogue set-top unit to the wall socket is still less than installation of a satellite set-top unit.[27] This gives access seekers more flexibility about the extent to which costs are recovered from consumers, so as to remain competitive with the heavily subsidised Foxtel and C&W Optus units.

Digital free-to-air

The delivery of digital services over the free-to-air broadcasting spectrum is constrained by regulatory arrangements. Commercial free-to-air broadcasters are currently prevented from using the spectrum allocated to them for digital services for multichanneling.

The same is true for national broadcasters (ABC and SBS), but this prohibition is subject to a review which is under way. However, on the basis of the submissions made to the review by the national broadcasters, the Commission understands that the

26 The Canberra Times, 24 December 1998, p. 13.

27 Foxtel submission of 30 June 1999, p. 10.

national broadcasters' digital spectrum would not be available to carry the channels of potential access seekers.[28] A government decision has yet to be made on this issue.

Import competition and vertical integration
Other structural factors which may affect the level of competition are import competition and vertical integration. With respect to import competition, the only potential source would be from satellite. The limitations of this option for downstream retail pay TV providers are discussed above.

The degree of vertical integration is an important factor in relation to pay TV in Australia. As will be discussed in relation to downstream services, there is a very high degree of vertical integration between wholesale carriage and retail supply.

Finally, the lack of availability to new entrants of premium programming within the current Australian market will inhibit the roll out of expensive infrastructure, as such programming drives penetration.

Taking the above factors into account, the Commission considers that declaration of an analogue pay TV cable carriage service would not be likely to promote competition to any significant extent in markets for the supply of analogue pay TV cable carriage services in dual and single-cabled metropolitan areas. Nor would declaration remove obstacles to end-users of retail pay TV services gaining access to those services, insofar as those obstacles consisted of lack of access to delivery mechanisms.

However, the Commission considers that it will promote competition in downstream markets. The reasons for this conclusion will now be discussed.

Downstream services — retail pay TV

Description

The pay TV retail product at its most fundamental level is a multi-channel television entertainment and news service delivered to the home by either cable, satellite or MDS and made available to the general public on payment of subscription fees.

The multi-channel package is built around sports and movie channels, these being generally recognised as the drivers of pay TV subscriptions. The package is filled-out by a range of speciality or niche channels. While sports and movies may drive subscriptions, the number and diversity of channels offered is ultimately influential in determining a subscriber's choice of service provider.

There are currently five pay TV service providers in Australia:

- Foxtel, delivered by Telstra cable or C&W Optus satellite, which currently has more than 500 000 subscribers;

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28 Submissions of the SBS Corporation and the Australian Broadcasting Corporation to the *Review into Multi-channelling by the National Broadcasters*, February 1999.

- Austar, delivered by its own MDS systems, C&W Optus satellite and its own cable in Darwin, which currently has around 300 000 subscribers;
- C&W Optus, delivered by its own cable, which currently has around 200 000 subscribers;
- Neighborhood Cable, delivered by its own cable in Mildura; and
- TARBS, delivering by its own MDS systems, and potentially by satellite.

The Commission is aware of a number of potential pay TV operators, such as Multicultural Marketing Network and Dergat Pty Limited, which are providing, or have plans to provide, a range of niche of ethnic services.

It will be noted from the above that the retail industry has a high degree of vertical integration through to the wholesale delivery infrastructure. The integration is achieved either by control of their own delivery systems or through long-term supply arrangements with infrastructure providers which have significant shareholdings in the retail provider.

The industry also has a degree of vertical integration with respect to programming, particularly programming that drives pay TV subscriptions such as sports and movies.[29] This integration has generally been achieved through long-term program supply contracts with production companies or rights holders related through shareholders to the retailers (for example, Foxtel and Fox Sports).

As discussed below, viable entry into the retail industry can be achieved only by providing niche programming as part of an incumbent's branded service. In contrast, access seekers have stated that they require access to the retail customer for their own branded service. Access seekers emphasised that 'separate branding is the preferred and optimum outcome, since this maximises the opportunity for product differentiation and therefore price and product competition, to the end-users' benefit'[30]. Most access seekers have stated that they would prefer to come to a commercial arrangement with the access provider in relation to services such as billing. This would be more efficient for the consumer and the service provider. However, access seekers wish to control how their channels are branded, priced and packaged.

Relevant market

The product dimension

Concurrent with its views on the wholesale carriage market, the Commission considers that all retail pay TV services are part of one market irrespective of delivery means.

29 Foxtel owns five of the 38 channels currently available on its cable service, and has interests in a further eight channels. Fox Sports is a wholly owned subsidiary of News Limited, which has a 25 per cent interest in Foxtel. (*Foxtel submission of 30 June 1999*).

30 TARBS, Submission of 30 June, p. 5

As an entertainment and news service, the closest potential substitutes to the pay TV product would appear to be free-to-air television, home video rentals, cinema, radio and newspapers and magazines.

The Commission does not consider that cinema, radio and newspapers and magazines are close enough substitutes to be considered part of the same retail market in which pay TV services are supplied. The out-of-home experience of going to the cinema means it is not substitutable for in-home pay TV. Radio does not have the essential visual element of pay TV. Newspapers and magazines don't have the 'moving-picture' element.

Free-to-air television and home video rentals both offer video entertainment in the home and may be considered the closest potential substitutes for pay TV. With respect to home video rentals, however, it is not considered close enough to pay TV because it is not able to provide perishable information such as live sporting events and the daily news. It is also less convenient to access (because of the need to leave the home to purchase the product).

Turning to potentially the closest substitute, the Commission has come to the view in past enforcement actions under Part IV of the Act that pay TV is not in the same market as free-to-air television. It remains of this view, in particular because:

- a pay TV service is generally a multi-channel television service, whereas a free-to-air service is restricted to a single-channel service under current statutory requirements in Australia;

- subscribers to pay TV services must pay fees for receiving those services whereas viewers of free-to-air services do not pay for reception;

- significant numbers of pay TV subscribers willingly pay fees for pay TV services despite the availability of free-to-air services;

- the commercial economics of a pay TV business differ significantly from those of a free-to-air business in that pay TV operators receive their main source of revenue from subscribers whereas free-to-air broadcasters (except the national and community broadcasters) receive their main source of revenue from advertisers;

- pay TV service providers will seek to maximise subscriber revenues by transmitting programs which are of direct appeal to existing and potential subscribers; this is in contrast to free-to-air broadcasters who seek to maximise advertising revenue by broadcasting programs with mass appeal which attract advertisers; these are not necessarily the same thing;

- the commercial economics of a pay TV business and its multi-channel nature provide a pay TV operator with the commercial incentive and technical capacity to differentiate its pay TV service from that of a commercial single-channel free-to-air broadcaster;

  - multichanelling by free-to-air broadcasters using digital spectrum is currently prohibited, although a review is under way as to whether the national broadcasters (ABC and SBS) should be permitted to provide multichanelling (the general prohibition on multichanneling must be reviewed by the Minister before 31 December 2005);

- pay television has a distinctive programming profile that free-to-air broadcasters cannot compete with directly, particularly with regard to first run movies, but increasingly with regard to televised sport — for example, the Nine network no longer broadcasts generic sporting programs during the weekend;

- the evidence of the pricing behaviour of pay TV service providers in Australia is that they are more closely constrained by the market behaviour of another pay TV operator than of a free-to-air broadcaster;

In overseas markets in which the pay television industry is more mature, regulators have still tended to take the view that the pay television market is a separate product market.

- The European Commission has concluded that pay TV constitutes a product market separate from free-to-air since pay TV is mainly financed by subscribers, whereas free-to-air relies on advertising, and that the conditions of competition are accordingly different for the two types of commercial television.[31]

- The Federal Communications Commission (the FCC) in the US has concluded that the availability of single-channel free-to-air broadcast services is insufficient to constrain the market power of multi-channel pay TV service providers.[32]

- The Federal Trade Commission in the US has concluded that there is a separate pay TV market.[33]

Nonetheless, the Commission will keep these matters under review as convergence and digital broadcasting develop.

The geographic dimension

A potential customer's range of alternative pay TV services is limited to services available in the area where the customer lives. A customer cannot access services available in other areas without moving house to that area.

For this reason, the Commission considers that geographic markets can be categorised according to the particular range of services available in a customer's area. In view of the vertically integrated nature of the industry, the availability of retail pay TV services

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31 Decision of the Commission of the European Communities, published in the Official Journal, L.364/1, 31 December 1994 (IV/M.469 — MSG Media Service).

32 The First Annual Report of the FCC in the matter of *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, CS Docket No. 94-48, 28 September 1994 at paragraph 101. The reluctance of the FCC to include free-to-air broadcasters and video rentals in its analyses of video markets in its Fifth Report on the same matter was criticised by FCC Commissioner Harold Furchgott-Roth.

33 *In the matter of Time Warner Inc, Turner Broadcasting System Inc, Telecommunications Inc, Liberty Media Corporation,* Docket No. C-3709.

broadly corresponds to the availability of different carriage services. Accordingly, the Commission considers that the relevant retail geographic markets in which to assess the effects on competition of declaration would broadly correspond to the relevant wholesale geographic markets.

In particular, the Commission expects that the most significant effects on competition of declaration would be felt in the market for the supply of retail pay TV services in cabled metropolitan areas. This is the geographic market for the supply of retail pay TV services which would attract the most interest from pay television service providers.

Three pay TV services are available in dual-cabled areas: the Foxtel cable service, the Optus Vision cable service and the TARBS MDS service (where receivable).

Both Foxtel and C&W Optus offer ‘tiered’ services comprising basic packages with optional higher-level channels or tiers which can be acquired only after a basic package has been acquired (buy-through). However, Foxtel and C&W Optus differ in terms of how their tiers are offered.

Foxtel’s cable service includes a ‘Basic’ package of 30 channels (including the five free-to-air channels) for $44.95 or an ‘Entertainment Plus’ package of 34 channels for $54.90. Through these packages, subscribers can subscribe to other niche channels. In addition, channels such as ‘Adults Only’, ‘World Movies’, ‘Antenna’ (Greek language) or ‘RAI’ (Italian language) are offered for an additional fee per channel.

C&W Optus’ packages include ‘First Choice’ (21 channels including the five free-to-air’s for $19.95), ‘SuperSport’ (24 channels for $29.95), ‘Movie Magic’ (24 channels for $29.95) and ‘Deluxe’ (27 channels for $39.95). Niche buy-throughs include ‘World Movies’, ‘Adults Only’, ‘Mega’, ‘Antenna’, ‘RAI’ and ‘NHK’ (Japanese language).[34]

The C&W Optus strategy relies heavily on bundling of pay television and other telecommunications services. The basic C&W Optus package is available for $14.95 if the subscriber also subscribes to the Optus Local Telephone Service.

A number of niche and other channels are available non-exclusively on both Foxtel and C&W Optus, including CNN, Sky News, TNT, Cartoon Network, TVSN, CMT and BCNBC.

In contrast, TARBS offers an ‘a la carte’ service where subscribers can subscribe to any channel or combinations of channels of their choice.

TARBS offers a service focused on niche ethnic channels plus an adult channel ‘Nightmoves’. Its current ethnic channels are ‘Teleitalia’ (Italian), ‘Dragon TV’ (Mandarin), TV Chile, RTVE (Spanish), ESC1 (Egyptian), LBC (Lebanese) and The Filipino Channel (Tagalog). It plans to offer a further 12 foreign language channels (Italian, Cantonese, Arabic, Filipino, German, Japanese, French, Polish, Portuguese, Vietnamese and Greek). It also plans to include channels devoted to sports and racing, children’s programs, movies and foreign films.

34 The *Sydney Morning Herald*, op. cit.

Foxtel and C&W Optus compete on the basis of their largely exclusive packages which include channels designed to appeal to the general public as well as niche channels which are of more limited appeal. TARBS competes at the niche end of the market with both C&W Optus and Foxtel.

Generally, two pay TV services are available in single-cabled areas: one or other of the Foxtel or Optus Vision services, and the TARBS MDS service (where receivable). In areas where there is no Foxtel cable service, there may be three services available (i.e. C&W Optus cable, Foxtel satellite and TARBS MDS).

The Foxtel satellite service offers similar packages to the Foxtel cable service but with fewer channels (for example, the 'Basic' satellite package has only 21 channels compared to 30 on cable).

Effect on competition

In the cabled metropolitan market for retail pay television (as for pay TV markets in general across Australia), there are significant barriers to entry for carriage service providers. The barriers derive from delivery and programming constraints previously discussed:

- there are economies of scale and high sunk and fixed costs involved in cable deployment: unless there is a 'greenfields' roll-out such as by Neighborhood Cable in Mildura and Austar in Darwin or there are other major revenue streams from the cable, it is not considered that the returns from pay TV alone would recoup the investment required in a competitive environment;

- there are capacity and technical limitations with video delivery by means of MDS;

- there are significant economic difficulties in using a satellite platform such as PanAmSat-8; and

- most key sports and movie programming rights have been exclusively tied-up by either Foxtel or C&W Optus. Without these subscription drivers, it is not considered likely that a new entrant would earn enough revenue to fund a high cost delivery network.

Compounding the delivery and programming constraints is the fact that the relevant retail pay TV markets in Australia are relatively small. The 6.2 million television households in Australia compare with 99 million in the US and 22 million in the UK.

Because the most attractive programming is now held exclusively by Foxtel and C&W Optus on a long term basis, declaration would not be likely to result in competition in the mainstream of the retail pay television market. Pay television service providers would not be able to acquire the subscription drivers needed to compete effectively with Foxtel and C&W Optus for customers who subscribed on the basis of movies and sports.

C&W Optus announced in mid-June 1999 that it had renegotiated its financial deal with the Hollywood studios which supplied it with movies. Mr Chris Anderson, the CEO of C&W Optus, announced that, under the deal, the studios supplying exclusive content to

Optus Television would be free to supply content to other operators. That content would be available only if other operators made their content available to Optus on comparable terms. The changed arrangement have yet to have an impact in the metropolitan market, in that pay television operators still supply exclusive packages to subscribers.

Niche programming

In Australia, niche entry into pay TV markets has generally been achieved through suppliers of programming content compiling their own channels and wholesaling them to the existing vertically-integrated pay TV service providers for distribution as part of their branded packages. For example, the 'World Movie' service is distributed as a tier in the Foxtel and Optus Vision services. Dergat Pty Limited's 'Greek Australian Television' (GAtv) has recently been launched as a separate tier in the Optus Vision service.

TARBS entry has been unique in that it acquired its initial channel line-up and its MDS distribution network relatively cheaply from the receivers of Australis. The Commission understands that neither Foxtel, C&W Optus or Austar bid for the channels or the network.

Pursuant to s. 152AB(4), the Commission considered the extent to which declaration would remove obstacles to end-users of retail pay television services gaining access to those services. The explanatory memorandum to the Trade Practices Amendment (Telecommunications) Bill 1996 stated:

> ... it is intended that particular regard be had to the extent to which the particular thing would enable end-users to gain access to an increased range or choice of services.[35]

End users already have access to some niche programming through existing pay TV suppliers. However, declaration will allow some underserved niche audiences access to programming which might not otherwise have been available.

The Commission considered whether declaration would lead to a more competitive situation for these niche services in terms of diversity and price.

Buy-through vs per channel

As noted above, where niche programming of this kind has been available as part of the Optus Vision or Foxtel packages, it has been available only on a 'buy-through' basis, and at premium prices. That is, subscribers who wished to acquire the channels have had to buy a package of basic programming first.

TARBS and other access seekers with similar kinds of programming submit that they have the potential to better serve the consumers of such programming by providing a wider range, more cheaply and with greater flexibility of packaging. In particular, subscribers would not be required to 'buy-through', with the attendant additional expense, but could simply subscribe to the channel or channels of their choice.

Having considered the submissions received in response to the draft report, the Commission's view is that acquiring services on a per channel basis would have limited

35 Item 6, proposed s. 152AB.

advantages. In particular, the cost of providing access to households which did not subscribe to one of the existing retail pay television services is likely to be significant enough to make it commercially unattractive to access seekers for large scale deployment. In households which already subscribed to an existing pay television service, the costs of providing access would be less, but there would not be any advantage to consumers from avoiding the cost of a basic package.

The main advantage of declaration is likely to be increased competition by niche service providers in those households which are already subscribers to an existing service. The problem that access seekers want to overcome is the lack of access to premium programming, which limits their opportunity to be the platform of first choice for a significant proportion of the market. Almost all submissions agree that there is consumer resistance to installing a second set-top unit in a household. Declaration would offer the opportunity for greater competition among niche services beyond the basic tier. It would also offer the opportunity for a wider range of niche services, many of which are not currently available.

The Commission notes that competition at this level may offer trade-offs between diversity on the one hand, and more intense competition between similar services on the other. Given that access seekers tend to offer a relatively wide range of niche services, this would become an issue only where capacity is limited. Further, given the rights to which access providers and others are entitled under s. 152AR(4), no programming will be displaced in providing access.

The Commission considers that competition will be promoted to a noticeable extent. Consumers of niche services (particularly foreign language services) are widely spread throughout Australian society, and will be likely to benefit in terms of price, quality and diversity of services.

The Commission considers that declaration of an analogue pay TV cable carriage service would be likely to result in the achievement of the objective of promoting competition in markets for the supply of pay TV services in cabled metropolitan areas to a material degree through customers gaining access to a wider range of services.

In summary, it would be likely to promote competition because:

- the high entry barriers in the retail pay TV industry caused by delivery and programming constraints would be alleviated by requiring access to the existing Telstra and C&W Optus broadband cable networks (in areas in which market entry by another delivery infrastructure is least likely); and
- niche pay TV service providers (as typified by TARBS, Multicultural Marketing Network) can offer an alternative range of programming to those offered by Foxtel and C&W Optus (which often offer the same niche channels).

The Commission considers that declaration would promote competition to a greater extent in single-cabled metropolitan areas than in dual-cabled metropolitan areas. The market structures of single-cabled and dual-cabled areas are similar but with the significant difference that single-cabled markets are more highly concentrated and far less competitive. Currently, competition occurs only at the niche end of the market and in those areas where MDS is receivable and TARBS competes with one or other of the cable services or the Foxtel satellite service. In certain areas there is currently no competition at all.

Achieving any-to-any connectivity

In addition to the impact of declaration on competition, the Commission must consider whether declaration is likely to result in the achievement of the objective of any-to-any connectivity in relation to carriage services that involve communications between end-users.

Any-to-any connectivity enables end-users to communicate with each other, irrespective of the network to which they are connected. As the explanatory memorandum to the Trade Practices Amendment (Telecommunications) Bill 1996 noted, the concept of any-to-any connectivity is not always relevant in the declaration context.

As noted in the Commission's discussion papers, the proposed declaration does not appear to be relevant in this context. Accordingly, the Commission proposes to give no weight to this consideration in assessing whether declaration of each eligible service is likely to promote the long-term interests of end-users.

Encouraging efficiency

The final matter to which the Commission must give consideration in forming a view as to the impact of declaration on the long-term interests of end-users is the likely impact on the efficiency objective.

There are two components to this objective, namely — whether declaration would encourage the economically efficient:

- use of infrastructure; and
- investment in infrastructure

for the supply of carriage services, and other services supplied by means of carriage services.

Economically efficient use of infrastructure

There are likely to be costs associated with the supply of the eligible services. These costs need to be considered in deciding whether to declare each service. In this regard, the Act requires the Commission to consider whether it is 'technically feasible' to supply and charge for certain services. It must consider, in particular:

- whether supplying and charging for the services is feasible in an engineering sense (i.e. having regard to the technology that is in use or available);
- the costs of supplying and charging for the services, and whether those costs are reasonable; and
- the effect of supplying and charging for the services on the operation or performance of telecommunications networks.

In the declaration context, the Commission applies these considerations to each eligible service under consideration. Where the Commission determines that it is 'technically feasible' to supply and charge for an eligible service, It will generally be of the view that declaration would encourage the efficient use of the infrastructure used to supply carriage services, or other services supplied by means of carriage services, unless this would discourage efficient investment.

Feasibility

In examining whether it would be feasible for access providers to supply and charge for analogue subscription television broadband carriage services, the Commission considered the current relationship between carriage providers and their customers. The Commission believes that since access to the carriage providers' networks is provided to affiliated retail pay television services, it would be technically feasible to provide access to other entities as well. The issue of additional costs which may be incurred in doing so, particularly when provided on an unbundled basis, is dealt with below.

The Commission also understands that conditional access systems can be partitioned to allow for different operators' packages to be provided on the one set-top unit without compromising database integrity. Access seekers have cited examples of service providers sharing conditional access systems, in Australia and overseas.[36] Foxtel has submitted that there are problems of technical feasibility in relation to such systems.[37] Given that there are such systems operating here and overseas, the Commission would discount claims that such an arrangement is not technically feasible. However, there may be costs associated with such systems, and these are dealt with below.

Access costs

Once a service is declared, those supplying the service (i.e. access providers) are subject to standard access obligations. These obligations impose 'compliance' costs on access providers. Accordingly, the Commission is required to consider costs involved in supplying and charging for the services.

In identifying costs involved in supplying and charging for a particular eligible service, the Commission is cognisant that the Part XIC framework enacted by Parliament provides for a staged approach to access regulation. The process begins with declaration. Following declaration, terms and conditions of supply are established, either through commercial negotiation, or through Part XIC processes such as the submission of an access undertaking or the arbitration of an access dispute. In the declaration context the Commission takes account of the direct costs necessary to comply with the standard access obligations.

Once the Commission has identified and, as far as possible, assessed the likely magnitude of the costs involved in supplying and charging for the eligible service, it is necessary to consider whether they are 'reasonable'. In the Commission's view, this should be evaluated from a commercial perspective.

The term 'reasonableness' is a relative concept and, accordingly, whether expected costs are 'reasonable' will depend on all the circumstances of each particular case. Based on its experience to date, the Commission suggests that costs are likely to be regarded as reasonable where they are not so high as to be unreasonable. They are likely to be unreasonable if there is no prospect of the costs being recovered (for example, from access seekers as part of the terms and conditions of access). In considering whether there is any prospect of costs being recovered, it may be appropriate to consider the likely demand for the service.

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36 The DirecTV/USSB DTH platform in the United States, which uses the NDS VideoCrypt Conditional Access System (CAS), the Foxtel/Austar/Optus DTH platform in Australia, which uses the Irdeto CAS and the MultiChoice Middle East DTH platform in the Middle East, using the Irdeto CAS.

37 Foxtel submission II, 30 June 1999.

These costs are largely fixed in nature and consequently it may be appropriate to recover them over time, including a return on capital. This would promote efficiency and be consistent with normal commercial practice.

The Commission will also evaluate ‘reasonableness’ in the context of the long-term interests of end-users test. This involves considering the significance of the costs to the access provider relative to the direct benefits, and the extent to which the costs are likely to be passed on to end-users in terms of higher prices.

In both discussion papers the Commission sought details of the costs involved in supplying and charging for the subscription television broadband carriage service.

C&W Optus identified the following principal costs in supplying pay television via cable:

1. rolling out the cables;
2. connecting customers to the cable;
3. content supply; and
4. retailing costs.

Telstra identified costs associated with installation of set-top units, customer service, integration of subscriber management and conditional access systems, and setting up playout facilities. It also identified costs associated with renegotiating licence arrangements.

Telstra argued that the declaration of the ancillary services set out in Annexure B of the initial service description would also impose significant costs, because it would require the modification of ‘existing databases and systems to provide an integrated carriage [and] network management service to access seekers without comprising network systems and data integrity’.[38] The Commission has decided not to include Annexure B in the service description because it considers inclusion to be unnecessary, given the standard access obligations. However, if there were costs generated by providing one or more of the services in Annexure B, they may also arise pursuant to the standard access obligations.

The Telstra submission stated that declaration would require the access provider to modify its systems to interface with the access seeker’s systems.

The Commission has considered the costs identified by access providers and seekers in the provision of the service, and considers them to be reasonable. Where such costs do arise, the Commission notes that access seekers have shown a preparedness to meet the reasonable costs to cable owners of providing services. Access seekers have also shown a willingness to provide some elements of the pay television service (such as conditional access and subscriber management systems) themselves, where this is cost effective. The Commission does not consider the costs that access seekers would incur

38 Telstra Submission at p. 20.

in paying for or providing these services would be such as to jeopardise the viability of their services.

Hence, the Commission considers that the costs of supplying and charging for subscription television broadband carriage service are reasonable.

Effect of access on networks

In addition to the compliance costs, there may be spillover costs in terms of protecting network integrity. Accordingly, the Commission will consider the impact of third party access on the operation or performance of telecommunications networks. Some submissions expressed concerns that the declaration of the service described in Annexure B would require access providers to give up control over commercially sensitive subscriber data and that granting access to conditional access equipment would affect the 'stability and robustness of an extremely complex system.'[39]

The Commission considers that the standard access obligations imposed on access providers by s. 152AR cover services ancillary to the carriage of pay television signals, and does not intend to declare the services set out in Annexure B of its initial service description. However, the same issue may arise in relation to compliance by access providers with the standard access obligations.

Access seekers have advised the Commission that it is possible for different service providers to use the same conditional access and subscriber management systems, while still restricting access to the other providers' subscriber databases.

Foxtel has provided relevant information on a confidential basis. Therefore the Commission could not test the information by seeking wider industry comment.

As noted above, given that there are such systems operating, here and overseas, the Commission would discount claims that such an arrangement has a significant impact on the integrity of telecommunications networks. The Commission considers that it is possible to have multiple users of ancillary services such as conditional access without compromising network integrity.

In any case, access seekers have indicated a preparedness to supply conditional access systems, although their preferred option would be to acquire such services as part of an integrated package.

Economically efficient investment in infrastructure

The Act requires the Commission to consider whether declaration would encourage economically efficient investment in the infrastructure by which carriage services, and services provided by means of carriage services, are supplied.

39 Foxtel Submission at p. 9.

In examining the likely impacts of declaration on economically efficient investment, and their extent, the Commission will examine the likely impact of declaration on economically efficient investment in:

- infrastructure by which the eligible services are supplied; and
- infrastructure by which other carriage services, and services supplied by means of carriage services, are supplied.

Infrastructure used to supply the eligible service

To examine the likely impact of declaration on the economically efficient investment in infrastructure by which the eligible services are supplied, the Commission will consider the impact of declaration on:

- the legitimate commercial interests of the access provider;
- incentives for investment in the infrastructure used to supply the eligible services; and
- incentives for investment in other infrastructure which could be used to supply the eligible services.

The legitimate commercial interests of the access provider

The Act requires the Commission to consider the legitimate commercial interests of potential access providers, including the ability to exploit economies of scale and scope.[40] Other legitimate commercial interests include the access provider's interest in meeting contractual commitment and in earning a normal commercial return on investment.

It was argued in some submissions that the value of retail pay television brands would be compromised where programming from access seekers is available via set-top units owned by the retail pay TV provider. The Commission considers that if the brands are based on programming and service valued by consumers, it is unlikely that their value will be affected by other programming available via the set-top unit.

Nor would declaration adversely impact upon the ability of access providers to meet contractual commitments. Consistent with s. 152AR(4) the Act, which sets out exemptions to the standard access obligations, the access provider would have priority for its proposed uses of the network.

Pricing principles

In response to the draft report, C&W Optus has reiterated the argument made in its original submission that if pricing of access to this service took into account its legitimate commercial interests (as the Act requires) and the Commission’s access pricing principles, then such pricing must reflect the full cost of its original investment in the HFC network. If pricing did reflect this cost, then C&W Optus argued that it

40 Paragraph 152AB(6)(b) of the Act.

would charge access seekers amounts that would make it commercially impracticable for a niche service provider to enter the market.

The C&W Optus argument appears to be based on several misconceptions. First, it appears to assume that the direct access model underlies the Commission’s reasoning. This is not the case. Access seekers recognise that to obtain an integrated service, the amount they receive for their channels from access providers will be net of costs of supplying those services. However, it is not reasonable to expect them to bear the initial costs of network roll out when the market value of those assets has been written down significantly, because of changes to demand and supply conditions, and when other content providers with similar services are not bearing such costs. This is certainly not what is implied by the use of replacement cost methodology, which should equate to the present day cost of replacing the asset with another asset with the same service potential and is the hypothetically least-cost option under current technology (best in use or commercially available technology). Regard would also be had to current market values which such estimates would be trying to approximate. If reasonable compensation is therefore made for the costs of supplying pay TV, access seekers are still likely to have sufficient margins to offer their services.

C&W Optus has argued that there is no evidence of market failure that would justify declaration. The Commission considers that there is sufficient evidence of service providers having difficulty gaining access to cable infrastructure through commercial negotiations to justify declaration. However, it should be noted that declaration does not exclude the possibility of issues being resolved through commercial negotiations, and offers a framework for disputes about access to be resolved.

Accordingly, the Commission considers that declaration of an analogue pay TV cable carriage service is unlikely to affect the legitimate commercial interests of the access provider detrimentally.

C&W Optus also argued that declaration would affect some access providers disproportionately, as some access providers would benefit from exemption provisions not available to C&W Optus. In the Commission’s view, this is potentially true for all declared services, given that individual exemptions from the standard access obligations are available under s. 152AT, and given the limits to standard access obligations under s. 152AR(4). The Commission is aware that Foxtel and Telstra have cited an exemption based on pre-existing contractual rights when negotiating with access seekers. However, the Commission does not consider that declaration of the service under consideration would unfairly penalise C&W Optus as against other access providers, as such claims have yet to be tested.

Incentives for investment in the infrastructure

While declaration will not have an impact on the initial investment in the infrastructure, it may distort the provider’s maintenance, improvement and expansion decisions leading to inefficient investment, which harms the long-term interests of end-users.

For instance, some submissions indicated that an analogue specific declaration would discourage investment in analogue wire line networks and skew incentives toward the investment in digital technology. Similarly, other submissions argued that a declaration limited to line links would lead to inefficient investment in non-wire line forms of carriage. In other words, the access provider may have an incentive to under-invest, or modify the nature of its investment, in order to limit the scope for third party access to its network. Accordingly, the Act requires the Commission to consider the impact of declaration on the incentives for investment in 'the infrastructure by which the services are supplied'.[41]

The Commission believes that the impact of declaration on the current environment should be considered in forming a view on this issue. Since a similar service is already declared (pursuant to the deeming statement), the effect of the analogue-specific declaration on the decision to invest should not be material. The deeming statement was issued on 30 June 1997, effectively declaring pay TV services. At that time C&W Optus and Telstra were still in the process of building their networks and did not cease further buildout until well after this date.

Similarly, new infrastructure providers such as Austar, NorthPower, and ACTEW either continued their buildout or continued their plans to develop a broadband network. If declaration were a significant deterrent to infrastructure buildout, it would have been expected that no development or further expansion would have taken place after the deeming statement was issued.

The Commission would be concerned should declaration lead to Telstra and/or C&W Optus not expanding their networks but is of the view that such an outcome is not made more likely by declaration.[42]

Further, to the extent there are concerns with the application of the declaration to particular networks, the exemption process available under Part XIC can be used.

Incentives for investment in other infrastructure

In addition to considering the impact of declaration on incentives for investment in the infrastructure by which the eligible services are supplied, the Commission will also consider the impact of declaration on investment in other customer access infrastructure which could be used to supply these services.

As discussed above, some of the submissions raised concerns that declaration of an analogue specific wire line service would skew investment toward satellite and digital transmission modes. The Commission again notes that, in the current environment, such investment incentives already exist. The proposed declaration may slightly reinforce this incentive but it is unlikely to significantly alter current investment incentives.

In the Commission's view, declaration is likely to actually encourage efficient investment in infrastructure. It will facilitate market entry and enable service providers to obtain information about demand characteristics and the likely responses of competitors, thus reducing the risks associated with infrastructure deployment. This will enable service providers to make efficient decisions about when to deploy additional infrastructure.

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41 Paragraph 152AB(6)(c) of the Act.

42 Based on the submissions, Optus is planning further buildout in Adelaide, Brisbane and Perth.

Some of the new entrants were particularly concerned that declaration would have a significantly negative impact on their investment at a time when they are commencing deployment of their networks. The Commission does not believe that declaration is likely to be a significant deterrent to efficient investment. However, if service providers are concerned about the impact of declaration on their investment decisions, then it may be appropriate for them to apply for an exemption pursuant to s. 152AT of the Act. Relevantly, s. 152AT confers power on the Commission, upon application, to make an order exempting a person from one or more of the standard access obligations where it is satisfied that doing so will promote the long-term interests of end-users. The order can be unconditional or subject to conditions specified in the order (for example, an expiry date).

Infrastructure used to supply other services

The Commission considered the impact of declaration on investment in infrastructure used to supply other communications carriage services, or services provided by means of communications carriage services.

Infrastructure used to supply analogue pay TV services is often capable of supplying a range of other telecommunications services, such as data or voice services. This has been true of the HFC cable networks deployed by C&W Optus and Telstra, and is true of the networks planned by ACTEW and NorthPower.

As with the infrastructure used to supply the eligible services, the effect of the existing declaration on investment should give a reasonable guide to the impact of declaration of the service under consideration. The existing declaration does not appear to have inhibited the roll-out of networks used to supply other services.

Conclusions

In the Commission's view:

It is technically feasible for the subscription television broadband carriage service to be supplied and charged for. While there will be costs in complying with the standard access obligations, these costs are reasonable, and can be met by access seekers without affecting their commercial viability.

Access providers and access seekers can negotiate access prices which enable the access provider to earn a commercially acceptable return on investment. These prices would protect incentives for investment in alternative infrastructure.

Declaration of the subscription television broadband carriage service will enable service providers to make efficient decisions about whether to roll out alternative infrastructure.

Declaration of the subscription television broadband carriage service is likely to facilitate investment in telecommunications infrastructure by reducing the risks associated with entry, leading to more innovative services and greater competition on price and quality of service.

Conclusions

The Commission compared two future scenarios; one with declaration and the other without declaration.

Scenarios

Promotion of competition

The Commission considers that, if the analogue specific broadband carriage service were declared, competition in the market for retail pay TV services would be promoted to a material extent. In particular, suppliers of niche services such as ethnic programming would be able to offer a wider range of services more cheaply than current suppliers of such services. The greater certainty provided by the new declaration would encourage access seekers to exercise their rights.

While the potential subscriber bases for these services are not as large as for mainstream programming, programming costs tend to be less expensive.

In the absence of declaration, the Commission considers it unlikely that viable entry to the retail pay TV market would be possible for new providers of such services in areas that are already cabled. The uncertainty over the status of the existing declaration is likely to be a significant deterrent to access seekers exercising their rights under it.

The Commission considers the barriers to entry in this market, including the lack of availability of premium programming and the cost and limitations of alternative means of carrying the services, to be significant. In addition, the vertical integration between the retail pay TV service providers and the providers of the cable carriage service provide an incentive for the latter to restrict access to their cables. If the service is not declared, it is likely that a narrower range of programming would be available, and at higher prices, than would otherwise be the case.

Any-to-any connectivity

The Commission does not consider that declaration would have any significant impact on this issue.

Encouraging the economically efficient use of, and economically efficient investment in, the infrastructure

The Commission considers that, if the analogue specific broadband carriage service were declared, an effect could be expected comparable to the declaration of the current broadcast access service.

Access providers have argued that the perceived lack of validity of the declaration explains the willingness of companies to invest in cable infrastructure. The Commission notes that a significant proportion of the investment made in cable infrastructure was undertaken in anticipation of a valid access regime being put into place. The Commission does not consider that the greater certainty provided by the new declaration would create a greater disincentive to investment than the existing declaration.

The Commission considers that declaration would not have significant negative impacts in terms of technical feasibility and costs of providing access. The Commission also considers, on the basis of the impact of the availability of an existing declared broadcast access service, that declaration would not discourage or distort investment in infrastructure.

The Commission would expect planned investments in subscription television infrastructure to continue.

If the service were not declared, the Commission anticipates a similar outcome.

Conclusion

The fundamental argument put by submissions opposed to declaration of the analogue service is that regulatory intervention should only address clear market failure, and that no such failure is evident in any of the markets relevant to this inquiry. Telstra, Foxtel and Cable & Wireless Optus argued that the necessary conditions for the exercise of market power do not exist in these markets. In particular, they argued that there is no 'bottleneck' in the market for carriage of subscription television services, and that without such a bottleneck, there is no basis for the Commission to find that declaration would be in the long term interests of end users. Further, they argued that prices being charged are close to or below cost, so that no monopoly pricing is involved.

The Commission notes that there is competition between the major providers of retail subscription television services over cable. Nonetheless, it considers that the structure of the markets is such that regulatory intervention is necessary. Each of the carriage providers has an incentive to restrict access to the infrastructure it controls, because of the vertical links between the carriage and retail pay TV services. Subscription television services provided by access seekers over the cable infrastructure would compete with the retail services provided by the owners of infrastructure, or by companies in which the owner has a major shareholding. Submissions described the difficulties faced in negotiating access to the cable infrastructure.

Because of their vertical integration with the retail pay TV services, the carriage providers can restrict access to their cable infrastructure without serious penalties in terms of loss of wholesale business. In these circumstances, programming services that might otherwise compete successfully with existing retail pay TV services or channels cannot do so effectively. The Commission considers competition in the retail pay TV market would be promoted if such programming services were given the opportunity to be provided to customers. Therefore the key issue is not merely one of whether existing pay television charges are excessive, but whether there is sufficient choice of programming.

The Commission notes the submissions that drew attention to the costs to access providers and seekers that may accrue from declaration. Where such costs do arise, the Commission notes that access seekers have shown a preparedness to meet the reasonable costs to cable owners of providing the service.

The Commission would be concerned if declaration of the analogue service inhibited the deployment of infrastructure to deliver broadband services, including pay TV.

However, it notes that the declaration of a similar service in July 1997 had no noticeable effect on the existing or proposed roll out of services. In addition, the regulatory framework provides for exemptions from the standard access obligations where this would promote the long-term interests of end-users.

In the Commission's view, declaration of the analogue specific broadband carriage service will promote the long-term interests of end-users of carriage services or of services provided by means of carriage services.

Appendix 1. Initial service description

Analogue service description

Annexure A

The **analogue subscription television broadband carriage service** is a point-to-multipoint service for the carriage of specified signals by means of line links from a facility owned, controlled or operated by a carrier or carriage service provider to conditional-access customer equipment at an end user's premises in Australia.

Where the words or phrases used in this Annexure are defined in the *Trade Practices Act 1974* or the *Telecommunications Act 1997*, they have the meaning given in those Acts.

In this Annexure, specified signals means analogue signals used to transmit a subscription television service.

Annexure B

The **analogue subscription television broadband carriage — network Management service** is the service of:

1. supplying, installing and disconnecting lines, conditional access equipment or other equipment to enable particular end-users to receive specified signals carried by means of the supply by a carrier or carriage service provider of the Analogue Subscription Television Broadband Carriage Service;

2. conditioning customer access equipment to receive specified signals requested by end-users; and

3. maintaining an end-user database of:

    4. the identity of those end-users to which specified signals are carried by means of the supply by a carrier or carriage service provider of the Analogue Subscription Television Broadband Carriage Service; and

    5. the specified signals the end-users' conditional-access customer equipment is conditioned to receive.

Where the words or phrases used in this Annexure are defined in the *Trade Practices Act 1974* or *the Telecommunications Act 1997*, they have the meaning given in those Acts.

In this Annexure, Analogue Subscription Television Broadband Carriage Service means the service described in Annexure A.

Technology-neutral service description

Annexure A

The **technology-neutral subscription television broadband carriage service** is a point-to-multipoint service for the carriage of specified signals by means of line links from a facility owned, controlled or operated by a carrier or carriage service provider to conditional-access customer equipment at an end user's premises in Australia.

Where the words or phrases used in this Annexure are defined in *the Trade Practices Act 1974* or the *Telecommunications Act 1997*, they have the meaning given in those Acts.

In this Annexure, specified signals means signals used to transmit a subscription television service.

Annexure B

The **technology-neutral subscription television broadband carriage – network management service** is the service of:

(a) supplying, installing and disconnecting lines, conditional access equipment or other equipment to enable particular end-users to receive specified signals carried by means of the supply by a carrier or carriage service provider of the Technology-Neutral Subscription Television Broadband Carriage Service;

(b) conditioning customer access equipment to receive specified signals requested by end-users; and

(c) maintaining an end-user database of:

1. the identity of those end-users to whom specified signals are carried by means of the supply by a carrier or carriage service provider of the Technology-Neutral Subscription Television Broadband Carriage Service; and

2. the specified signals the end-users' conditional-access customer equipment is conditioned to receive.

Where the words or phrases used in this Annexure are defined in the *Trade Practices Act 1974* or the *Telecommunications Act 1997*, they have the meaning given in those Acts.

In this Annexure, Technology-Neutral Subscription Television Broadband Carriage Service means the service described in Annexure A.

Appendix 2. Submissions

Submissions were received from the following organisations

- Cable & Wireless Optus
- Foxtel
- Austar
- Australian Subscription Television and Radio Association
- Paul Budde Communications Pty Ltd
- Australian Broadcasting Authority
- AAPT
- Austa Holdings Pty Limited
- NorthPower
- ACTEW Corporation
- Australian Telecommunications Users Group Limited
- Television & Radio Broadcasting Services Australia Pty Ltd
- Telstra
- Seven Network Limited

Submissions were received in relation to the draft report from the following organisations

- Paul Budde Communications Pty Ltd
- Cable & Wireless Optus Limited
- AAPT Limited
- Television and Radio Broadcasting Services Australia Pty Ltd
- Seven Network Limited
- Australian Telecommunications Users Group Limited
- Foxtel Management Pty Ltd
- Telstra
- Australian Medical Television Pty Ltd
- Rowcom Holdings Pty Limited
- NorthPower

Appendix 3. Revised service description

The **analogue subscription television broadcast carriage service** is:

> A service for the carriage, by means of lines, of analogue signals used for the purposes of transmitting a subscription television service from a facility owned, controlled or operated by a carrier or carriage service provider to any point on, or in, a line link, customer cabling, or customer equipment connected to that facility.
>
> Examples of this service are the delivery of analogue signals used for the purposes of transmitting a subscription television service to:
>
> (a) an end-user's television set;
>
> (b) conditional-access customer equipment of an end-user, or potential end-user, of a subscription television service;
>
> (c) a wall socket at the premises of an end-user, or potential end-user, of a subscription television service;
>
> (d) a point on a line link from which a lead-in connection may be run to the premises of an end-user, or potential end-user, of a subscription television service.

For the avoidance of doubt:

(1) this declaration covers a service even if the service is not provided exclusively by means of lines, e.g. if it is also provided by means of conditional-access customer equipment;

(2) this declaration does not cover a service provided partly by means of lines where the signals are carried to the boundary of a telecommunications network by means other than lines, e.g. by means of radiocommunication; and

(3) customer equipment and customer cabling shall be taken to be connected to a facility if it is connected to a line connected to that facility.

Interpretation
Where the words or phrases used in this declaration are defined in *the Trade Practices Act 1974* or the *Telecommunications Act 1997*, they have the meanings given in those Acts.