



FOXTEL MANAGEMENT PTY LIMITED

Submission to Australian Competition & Consumer
Commission

FOXTEL Special Access Undertaking

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1. Introduction

FOXTEL Management Pty Ltd and FOXTEL Cable Television Pty Ltd (together, **FOXTEL**) have lodged a special access undertaking (the **undertaking**) with the Australian Competition & Consumer Commission (the **Commission**) under s152CBA of the *Trade Practices Act 1974* (the **Act**).

The undertaking is in relation to the Digital Set Top Unit Service.

The Digital Access Agreement (**DAA**) appended to the undertaking sets out the terms and conditions of access to the Digital Set Top Unit Service¹.

In summary, the Digital Set Top Unit comprises:

- (a) Set Top Unit Services which are the provision of services for the reception and decryption of signals for a digital Subscription Television Service and a Related Service in customer premises by means of Conditional Access Customer Equipment and Customer Cabling;
- (b) Conditional Access Services which consists of:
 - (i) CA Services which are the services that allow a service provider to determine the entitlement of customers to receive particular signals for a digital Subscription Television Service and a Related Service through Conditional Access Customer Equipment and Customer Cabling;
 - (ii) Service Information Service which is the processing of information necessary to be received by Conditional Access Customer Equipment which permits the reception of a digital Subscription Television Service and a Related Service;
 - (iii) Smartcard Authorisation Verification Information Services which is the provision of information necessary to enable a service provider to verify which of its digital Subscription Television Services and Related Services are enabled on a Smartcard;
- (c) EPG Services which consists of the incorporation of data relating to programs transmitted on a service provider's digital Subscription Television Service into an electronic program guide; and
- (d) Modem Services which consist of services using a modem integrated with Conditional Access Customer Equipment which enable a customer to send to the provider of the content a reaction of the customer to that content.

The capitalised terms are defined in the SAU or the Digital Access Agreement attached to the SAU.

A special access undertaking can be lodged by a person who is, or expects to be, a carrier or carriage service provider supplying:

- (a) a listed carriage service; or

¹ Digital Set Top Unit Services are defined in Schedule 10 to the DAA as all of the services specified in Part A (Set Top Unit Services), Part B (CA Services), Part C (EPG Services) and Part D (Modem Services) of Schedule 1, which will be supplied by FOXTEL on the term and conditions set out in [the DAA], including any special terms and conditions set out in Schedule 1.

(b) a service that facilitates the supply of a listed carriage service, whether to itself or to other persons, so long as the service is not an active declared service: s152CBA(1).

The Digital Set Top Unit Service is a listed carriage service or a service that facilitates the supply of a listed carriage service. FOXTEL is a carriage service provider (according to the Full Federal Court)² which supplies the Digital Set Top Unit Service to itself and other persons. The Digital Set Top Unit Service is not declared, and therefore FOXTEL may give a special access undertaking to the Commission in relation to that service.

FOXTEL proposes that the undertaking be in force for 8 years.

This submission in support of the undertaking will assist the Commission's appraisal of the undertaking in the light of the criteria in s152CBD.

Any reference to a section or a Part of an Act in this submission is a reference to a section or a Part of the Act unless otherwise specified. All defined terms have the meaning set out in the undertaking or appended Digital Access Agreement, unless defined in this submission.

1.2 Structure of submission

The submission is divided into the following Sections:

- Section 1: Introduction;
- Section 2: Executive Summary;
- Section 3: Regulatory Framework;
- Section 4: Background to the Undertaking;
- Section 5: Assessment of non-price terms and conditions (other than Set Top Unit (**STU**), Conditional Access (**CA**) / Service Information (**SI**));
- Section 6: Provision of STU services to FOXTEL homes only;
- Section 7: Price; and
- Section 8: Undertaking Satisfies Criteria.

1.3 Expert reports

FOXTEL also attaches a number of expert reports and other evidence in support of its submission:

- Attachment 1: Henry Ergas, Charles River & Associates: Adjusted Access Pricing Model for Digital STUs;
- Attachment 2: Bill McDonald, Australian Spectrum Consultants Pty Ltd – Report on Satellite Amendments [**Part Confidential**];
- Attachment 3: Confidential Statement of Peter Campbell regarding the terms of FOXTEL's digital content agreements [**Confidential**];
- Attachment 4: Henry Ergas, Charles River & Associates: Reasonableness of Limiting the Supply of FOXTEL's Conditional Access Service; [**Part confidential**]
- Attachment 5: Peter Smart/Mr Ron Higgins, FOXTEL, Engineering Report;

² (2000) 102 FCR 555; [2000] FCA 1161.

- Attachment 6: Philip Williams – Frontier Economics: Report on Market Definition and Promotion of Competition **[Part Confidential]**.
- Attachment 7: NECG: FOXTEL Explanatory Material in Relation to STU Pricing. Part A: STU Access Pricing dated 4 June 2002; and Part B: Access Pricing Model for Digital Cable and Satellite STUs: Description of Cost Based Pricing Methodology dated 30 August 2002;
- Attachment 8: DN Ridehalgh, PricewaterhouseCoopers: Report on Cable IBAC Cost Schedules dated 13 July 2005 **[Confidential]**;
- Attachment 9: DN Ridehalgh, PricewaterhouseCoopers: Report on Satellite IBAC Cost Schedules dated 13 July 2005 **[Confidential]**;
- Attachment 10: DN Ridehalgh, PricewaterhouseCoopers: Independent Audit Report on the Schedule of Gross Capital Purchase Costs of Satellite Set Top Units (STUs) dated 13 July 2005; **[Confidential]**
- Attachment 11: Maria Martin, PricewaterhouseCoopers: Report on Gross Purchase Cost of Cable Set Top Units dated 19 January 2001 **[Confidential]**;
- Attachment 12: DN Ridehalgh, PricewaterhouseCoopers: Independent Review Report on FOXTEL's Digital Regulatory Accounting Procedures Manual dated 13 July 2005; **[Confidential]**
- Attachment 13: DN Ridehalgh, PricewaterhouseCoopers: Independent Audit Report on FOXTEL's Digital Access Pricing Model dated 13 May 2005, version 6, for the T1 period dated 13 July 2005; **[Confidential]**
- Attachment 14: Stephen Gray, SFG Consulting: The Effect of Franking Credits on FOXTEL's Cost of Capital;
- Attachment 15: Stephen Gray, SFG Consulting: A Beta Estimate for FOXTEL **[Part Confidential]**;
- Attachment 16: Mark Ettridge, Market Ridge Pty Ltd: Final Report, Consultancy Report to the Australian Competition and Consumer Commission, Subscriber Management and Conditional Access Systems dated 19 December 2001 **[Confidential]**;
- Attachment 17: Greg Woolstencroft, VPG Consulting: Response to Consultancy Report to the Australian Competition and Consumer Commission Regarding Subscriber Management and Conditional Access Systems dated 18 January 2002 **[Confidential]**;
- Attachment 18: John Paul, ACPG Pty Ltd: Identification of Media Distribution Mechanisms and Models in Australia; and
- Attachment 19: Folder of Statements in relation to market definition **[Confidential]**.

2. Executive Summary

2.1 Supply of Digital Set Top Unit Services

- Pursuant to the special access undertaking, FOXTEL will supply Digital Set Top Unit Services, including access to its Digital Subscriber Equipment, to enable access seekers to provide digital Subscription Television Services, Related Services and Access Seeker Modem Content to their subscribers.
- FOXTEL will supply the Digital Set Top Unit Services to access seekers to an equivalent quality as it supplies those services to itself.
- FOXTEL will only be obliged to supply Digital Set Top Unit Services to homes that receive the FOXTEL Subscription Television Service.

2.2 Non-price terms and conditions

- FOXTEL has amended the terms and conditions of the existing DAA to address some of the concerns raised by the Tribunal in its decision regarding FOXTEL's exemption application.
- FOXTEL will now supply 'Modem Services' to access seekers to enable access seekers to supply Access Seeker Modem Content to their subscribers. The supply of Modem Services will benefit access seekers by enabling their subscribers to view Access Seeker Modem Content and to relay their responses to the access seeker using the modem and remote control.
- FOXTEL has included all the terms of access to the FOXTEL EPG in the DAA instead of relying on commercial negotiation or expert determination to decide those terms of access.
- The term of the DAA has been extended from 5 years to between 5 to 8 years at the access seeker's election. Access seekers are able to choose the term most suited to their business structure. The range of terms available will also allow access seekers to enter content supply agreements of an average length, and recover their initial costs over the term of the agreement.
- Access seekers have a right to terminate the DAA on one month's notice (FOXTEL does not have a reciprocal right to do so). This right removes much of the commercial risk faced by access seekers in establishing a digital subscription television service.
- The DAA also provides for increased satellite capacity – that is, access seekers can use satellites other than the C1 satellite used by FOXTEL in conjunction with the undertaking. This will give additional choice to access seekers.
- FOXTEL submits that all other non-price terms and conditions are reasonable and usual in agreements of this kind.

2.3 Access to CA and SI services in non-FOXTEL homes

- The Tribunal accepted that FOXTEL should not be required to provide STUs in non-FOXTEL homes but suggested the possibility of FOXTEL 'unbundling' the provision of CA and SI services and providing those services to access seekers in relation to non-FOXTEL homes.

- FOXTEL has sound commercial reasons for bundling its content service with the provision of STUs and CA/SI services to its subscribers.
- FOXTEL submits that it would not be reasonable to compel FOXTEL to supply Digital Set Top Units, CA or SI services in non-FOXTEL homes. Significant technical and operational issues would be involved if FOXTEL supplied Digital Set Top Unit Services (including unbundled CA and SI services) to non-FOXTEL homes. Any possible benefit that might be derived from FOXTEL supplying these services is outweighed by the costs and inefficiencies which would result. Access seekers are able to supply those services themselves.
- FOXTEL also submits that the Commission does not have the statutory power to compel FOXTEL to supply Digital Set Top Units or CA and SI services to non-FOXTEL homes. To require FOXTEL to supply Digital Set Top Unit Services to access seekers in non-subscriber homes would not be giving access to existing FOXTEL infrastructure or services; rather, it would compel FOXTEL to install a Digital Set Top Unit in these homes or supply ancillary services such as CA and SI services when it does not supply those services in relation to its own business in that home.
- If the Digital Set Top Unit Service was declared, FOXTEL submits it would not be obliged to supply Digital Set Top Unit Services in non-FOXTEL subscriber locations.
- These findings are explained further in Section 6 and are supported by the expert report of Charles River Associates, economists (**CRA**).

2.4 Pricing methodology

- FOXTEL has not changed the pricing methodology set out in the DAA that was accepted by the Commission and the Tribunal as reasonable.
- However, PricewaterhouseCoopers has provided a number of reports in relation to the cost base as suggested by the Tribunal.

2.5 Conclusion

- FOXTEL submits that the undertaking satisfies the statutory tests of being consistent with the standard access obligations and being reasonable. In particular, the undertaking:
 - is in the long-term interests of end-users;
 - promotes competition by removing barriers to entry, and allowing access by other subscription television operators (in particular, niche operators) to FOXTEL's infrastructure;
 - balances FOXTEL's legitimate business interests with the interests of access seekers;
 - allows cost recovery by FOXTEL and a reasonable return on capital; and
 - provides certainty to access seekers.
- These submissions are developed below, and are supported by the attached expert reports and other evidence.
- For the reasons set out in this submission, and supported by the attached expert reports, FOXTEL submits that the Commission should accept the special access undertaking.

3. Regulatory Framework

3.1 Declaration

Part XIC regulates access to 'eligible services.' An 'eligible service' is:

- a listed carriage service; or
- a service that facilitates the supply of a listed carriage service

where the service is supplied or is capable of being supplied by a carrier or a carriage service provider: s152AL(1).

The Commission may declare that an 'eligible service' is a 'declared service' if it:

- holds a public inquiry under Part 25 of the Telecommunications Act (the **Telecoms Act**);
- prepares a report about the inquiry under s505 of the Telecoms Act;
- publishes the report within 180 days (approximately 6 months) prior to the date of making the declaration; and
- is satisfied that making the declaration will promote the long term interests of end users of the eligible service: s152AL(3).

In addition, where:

- a person gives the Commission a special access undertaking in relation to a service or proposed service;
- the undertaking is in operation; and
- the person supplies the service the subject of the undertaking to itself or others

the service is deemed to be a declared service: s152AL(7).

3.2 Standard access obligations (SAOs)

If a carrier or carriage service provider supplies declared services then:

- the carrier or carriage service provider is an **access provider**, and
- the declared services are active declared services: s152AR(2).

An access provider is subject to the SAOs set out in s152AR. If requested by an access seeker, these require an access provider to:

- (a) supply an active declared service to the access seeker to enable it to provide carriage and/or content services;
- (b) take all reasonable steps to ensure that the technical and operational quality of the active declared service is equivalent to that which the access provider provides to itself;
- (c) take all reasonable steps to ensure that the access seeker receives, in relation to the active declared service, fault detection, handling and rectification of a technical and operational quality and timing that is equivalent to that which the access provider provides to itself: s152AR(3).

However, the obligation to supply an active declared service in s152AR(3) does not exist to the extent that it would:

- (a) prevent an access seeker who already has access to the declared service from obtaining a sufficient amount of the service to meet its own reasonably anticipated requirements at the time the request was made;
- (b) prevent the access provider from obtaining a sufficient amount of the service to be able to meet its own reasonably anticipated requirements measured at the time the request was made;
- (c) prevent any person from obtaining (by the exercise of a pre-request right) a sufficient level of access to the declared service to be able to meet the person's actual requirements; or
- (d) deprive any person of a protected [pre-1997] contractual right: s152AR(4).

In addition, an access provider must, if requested by the access seeker:

- (a) permit interconnection of facilities it owns or controls, or in respect of which it is a nominated carrier, with the facilities of an access seeker to enable the access seeker to be provided with active declared services so that it can provide carriage and/or content services. Interconnection must be provided to an equivalent standard as the access provider provides to itself, or as required by the Telecoms Act: s152AR(5);
- (b) provide certain billing information to the access seeker in connection with the supply of the services: s152AR(6) & (7); and
- (c) supply to the access seeker "any service that is necessary to enable the [access seeker] to supply carriage services and/or content services by means of the active declared service and using [conditional access customer] equipment" if the access provider supplies an active declared service by means of such equipment: s152AR(8).

If the access provider is required to comply with "any or all" of the standard access obligations, (ie. it is not partly or wholly exempt, see 3.3 below), then the access provider must comply with the obligations:

- (a) on such terms and conditions as are agreed between it and the access seeker; or
- (b) failing agreement:
 - (i) if an access undertaking which has been approved by the Commission (under s152BS or s152CBA) deals with a particular subject matter: on the terms and conditions set out in the undertaking; or
 - (ii) if the access undertaking does not specify terms and conditions about a particular matter: on terms and conditions determined by the Commission under Division 8; or
 - (iii) if there is no access undertaking: on terms and conditions determined by the Commission following arbitration under Division 8: s152AY(2).

3.3 Exemptions

The Commission may grant exemptions to access providers from all or any of their standard access obligations in relation to specified services, on a class or individual basis: s152AS and s152AT.

The Commission may also grant anticipatory exemptions prior to a service being declared or commenced on a class or individual basis: s152ASA and s152ATA and other sections. The Commission's decisions in relation to anticipatory exemptions may be reviewed by the Australian Competition Tribunal (the *Tribunal*): s152AV.

The Commission can only grant an exemption if it is satisfied that the exemption will promote the long-term interests of end-users (*LTIE*): s152AS(4); s152ATA(4).

3.4 Access Undertakings

Carriers or carriage service providers can lodge access undertakings with the Commission. There are two types of undertakings that can be lodged – ordinary access undertakings and special access undertakings.

A carrier or carriage service provider can give an **ordinary access undertaking** in relation to a declared service, to comply with terms and conditions specified in the undertaking in relation to the standard access obligations: s152BS(1).

A carrier or carriage service provider may lodge a **special access undertaking** in respect of a listed carriage service or a service facilitating the supply of a listed carriage service so long as the service is not an active declared service: s152CBA.

Section 152AY(2)(b)(ii) and the note below s152CBA(3) make it clear that there is no statutory requirement for an access undertaking to specify all terms and conditions of access.

If a s152CBA special access undertaking is in operation (ie approved by the Commission):

- the service is deemed to be a declared service: s152AL(7); and
- the Commission can declare the service under s152AL(3), even if the service is to any extent covered by s152AL(7): s152AL(8).

An access undertaking prevails over an inconsistent result in any Division 8 arbitration: s152CGB. The Commission must have regard to the desirability of access disputes being resolved in a timely manner (including through the use of alternative dispute resolution methods such as mediation and conciliation): s152CLA. The Commission, if giving directions about negotiations (s152BBA, s152BBC), must have regard to the desirability of access providers and access seekers agreeing on terms and conditions in a timely manner: s152BBD.

3.5 Criteria for special access undertakings

Under s152CBD of the Act, before accepting a special access undertaking, the Commission must be satisfied that:

- it is consistent with the SAOs set out in s152AR of the Act (see 4.1 below);
- the terms and conditions of access set out in the undertaking are reasonable (see 4.2 below); and
- it is consistent with any ministerial pricing determination.

The last criteria is not applicable in this case as there is no ministerial pricing determination in relation to the Digital Set Top Unit Service. FOXTEL's submissions in respect of the remaining statutory criteria are set out below.

3.6 Consistent with standard access obligations

The Act does not set out specific criteria to guide the Commission's appraisal of whether undertakings are consistent with the SAOs. A consideration of assessments of undertakings published by the Commission reveals that in each instance, the Commission has approached the

analysis by determining whether the terms and conditions of the undertaking are either expressly or impliedly *inconsistent* with the SAOs.³

If the terms and conditions prevent or compromise an access provider's duty to satisfy the SAOs, then the Commission would be likely to conclude that the terms and conditions of the undertaking are inconsistent with the SAOs.⁴ Conversely, if the terms and conditions are not inconsistent with the access provider's ability to satisfy the SAOs, then the Commission is likely to find they are consistent with the SAOs.

The Commission has also decided that the phrase 'consistent with' takes its ordinary and natural meaning. That is, there should:

be some uniformity and adherence to the thing in question but there is no requirement for exact or complete correspondence....it requires correspondence of a broad or approximate kind.⁵

3.7 Reasonableness

The Commission can only accept a special access undertaking if it is satisfied that the undertaking is reasonable.⁶ In considering whether the terms and conditions of the undertaking are reasonable, the Commission must have regard to the following (each of which are discussed in detail at Appendix A to this submission):⁷

- (a) whether the terms and conditions promote the LTIE of carriage services or of services supplied by means of carriage services;
- (b) the legitimate business interests of the carrier or carriage service provider concerned, and the carrier's or provider's investment in facilities used to supply the declared service;
- (c) the interests of persons who have rights to use the declared service;
- (d) the direct cost of providing access to the declared service;
- (e) the operational and technical requirements necessary for the safe and reliable operation of a carriage service, a telecommunications network or a facility; and
- (f) the economically efficient operation of a carriage service, a telecommunications network or a facility.

This list is not exhaustive and the Commission may have regard to any other relevant matter.⁸

³ A Report on the Assessment of Telstra's Undertaking for the Domestic PSTN Originating and Terminating Access Services, July 2000 (**Report – Assessment of Telstra's Undertaking [PSTN]**) p 15-16; Assessment of Telstra's Core Services Undertakings – Preliminary View, 12 December 2003 (**Assessment – Telstra's Core Services Undertakings**) p 16; A Final Report on the Assessment of Telstra's Undertaking for the Line Sharing Service, August 2004 (**Final Report – Assessment of Telstra's Undertaking [Line Sharing]**) p 21; Assessment of Telstra's Undertakings for PSTN, ULLS and LCS Final Decision, December 2004 (**Assessment – Telstra's Undertaking [PSTN, ULLS, LCS]**) p 23.

⁴ Report – Assessment of Telstra's Undertaking [PSTN] p. 16; Assessment – Telstra's Core Services Undertakings p 16; Final Report – Assessment of Telstra's Undertaking [Line Sharing] p 21; Assessment – Telstra's Undertaking [PSTN, ULLS, LCS] p 23.

⁵ Australian Competition and Consumer Commission – A report on the assessment of the Analogue Pay TV Access Undertaking proffered by FOXTEL Management Pty Ltd December 2003, Confidential version (**ACCC Report – Analogue Pay TV Access Undertaking [Foxtel]**) p 11.

⁶ s152CBD(2)(b).

⁷ s152AH.

⁸ s152AH(2).

In determining whether the undertaking promotes the LTIE, regard must be had to the extent to which it is likely to achieve the following objectives:

- promoting competition in markets for carriage services and services supplied by means of carriage services (**listed services**);
- achieving any-to-any connectivity in relation to carriage services that involve communication between end users; and
- encouraging the economically efficient use of, and the economically efficient investment in, the infrastructure by which listed services are supplied⁹.

This list is exhaustive and the Commission may not have regard to other matters.¹⁰

In considering whether a special access undertaking is reasonable, the Commission must, as one of a number of considerations, have regard to whether the terms and conditions of the undertaking are in the LTIE. In contrast to the test for considering exemptions where the LTIE is the sole test, the Commission need not be *satisfied* that the undertaking is in the LTIE. Rather, this is simply one factor to consider as part of an overall assessment of reasonableness.

Essentially, the Commission is required to weigh up the above factors (and any others it considers relevant) to assess whether the undertaking is reasonable.

At this stage, it is worth noting that, while the Act currently gives equal weight to the various factors to be weighed up, a very recent Senate Committee Report has recommended that the objective of encouraging the economically efficient use of, and investment in infrastructure, be given primacy.¹¹

⁹ s152AB(2).

¹⁰ s152AB(3).

¹¹ 'The Performance of the Australian Telecommunications Regulatory Regime' released by the Environment, Communications, Information Technology and the Arts References Committee on 10 August 2005 (***The Performance of the Australian Telecommunications Regulatory Regime***) Recommendation 7.

4. Background to the Undertaking

4.1 Analogue service

On 1 September 1999, the Commission declared an analogue subscription television broadcast carriage service under Part XIC.¹² The declaration came into effect on 8 September 1999 when it was gazetted.

The declared service is described as:

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:

- an end-user's television set;
- conditional-access customer equipment of an end-user, or potential end-user, of a subscription television service;
- a wall socket at the premises of an end-user, or potential end-user, of a subscription television service;
- 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:

- this declaration covers a service even if the service is not provided exclusively by means of lines, eg if it is also provided by means of conditional-access customer equipment;
- 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, eg by means of radio communications; and
- 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.

Access requests were made to FOXTEL and Telstra Multimedia by TARBS and C7. In September 1999, TARBS notified the Commission of an access dispute under the Act. C7 notified the Commission of access disputes under the Act in August and September 2000. Pursuant to those notifications, the Commission began arbitrating the terms and conditions of access to the declared analogue service by TARBS and C7.

In June 2002, the arbitrations were put on hold by the Commission pending consideration by it of the FOXTEL/Optus Content Supply Agreement (**CSA**) and the proposed analogue access undertakings to be lodged by Foxtel and Telstra Multimedia in connection with the Commission's assessment of the CSA.

¹² Australian Competition and Consumer Commission 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*, October 1999 (**ACCC – Declaration of an Analogue Subscription Television Broadcast Carriage Service**) p 86.

On 21 November 2002, the Commission accepted Court enforceable undertakings under s87B of the Act by FOXTEL and Telstra Multimedia (amongst others) (the **s87B undertaking**). One of the undertakings given was to lodge ordinary analogue access undertakings under Part XIC. Consequently, on 21 November 2002, FOXTEL and Telstra lodged with the Commission ordinary access undertakings in relation to access to the declared analogue service. After a lengthy public inquiry process, the Commission accepted the undertakings on 25 March 2004, as it considered the proposed terms and conditions were reasonable.

Given the acceptance of the undertakings, C7 withdrew its notification of an access dispute on 9 June 2004, and TARBS withdrew its notification of an access dispute on 10 June 2004. These withdrawals were confirmed by the Commission on 17 June 2004.

4.2 Digital Exemption

As part of their s87B undertakings, FOXTEL and Telstra also provided digital access undertakings to the Commission. The FOXTEL Digital Access Undertaking provides that FOXTEL must give access to Digital Set Top Units and certain related services, such as CA and SI services, if FOXTEL commences supplying a digital cable subscription television service. The Digital Access Undertaking attaches a Digital Access Agreement (the **existing DAA**), which sets out all the terms and conditions of access, including the pricing methodology.

FOXTEL also undertook to commence supplying the digital cable and satellite subscription television service 12 months after it received a Final Order¹³ that it was exempt from the standard access obligations that would apply to that service under Part XIC, if it were declared. On 23 December 2002, FOXTEL applied to the Commission for a written order pursuant to s152ATA that it was exempt from the obligations referred to in s152AR that would apply in respect of a digital subscription television service in the event that service became an active declared service pursuant to Part XIC. FOXTEL sought the exemption on the basis that it would provide access in accordance with its Digital Access Undertaking and the existing DAA attached to the s87B Undertaking.

At the time of the exemption application, FOXTEL did not supply a digital cable subscription television service but wished to do so. FOXTEL also planned to expand significantly its digital satellite subscription television service. FOXTEL had always intended to provide access to its STUs in a digital environment, subject only to legislative certainty about the terms (including price) on which such access would be granted prior to investing in digitisation.

The service to which the exemption related was a digital subscription television service, which was described more fully as:

A service for the carriage of digital signals used for the purposes of transmitting a subscription television service by means of a hybrid fibre co-axial cable or satellite and services that facilitate the supply of that carriage service, including, without limitation:

- services that allow a service provider to determine the entitlement of end-users to receive particular services through conditional-access customer equipment (CA services);
- services for the processing of information necessary to be received by conditional-access customer equipment which permits the reception of a digital subscription television service (SI services);
- subscriber management services; and

¹³ An exemption which is upheld by any appeal.

- services for the reception and decryption of digital signals in customer premises by conditional-access customer equipment.

The order was to have effect until 2015, or the date on which the Digital Access Undertaking given under s87B ceased to be in force, whichever was the earlier.

FOXTEL submitted that the exemption would be in the LTIE as it promoted competition in the market in which subscription television services are supplied by providing access, on a reasonable basis, to FOXTEL's infrastructure. Such access would enable subscription television operators to compete in the delivery of subscription television. FOXTEL also submitted that the exemption would encourage the economically efficient use of, and investment in, infrastructure as it granted FOXTEL the certainty it required about the terms and conditions of access (including price) in order to make the very large investment in the infrastructure.

The Commission, after a lengthy period of public inquiry and with certain conditions attached, granted FOXTEL's exemption on the basis that it was in the LTIE. However, this decision was revoked by the Tribunal on appeal. In essence, the Tribunal concluded that FOXTEL would have invested in a digital service whether or not the exemption was granted. Consequently, it thought that the exemption was not in the LTIE because end-users lost the benefits of declaration of a digital service in circumstances where FOXTEL would have commenced that service even without an exemption. A more detailed examination of the basis for the Tribunal's decision is set out in Section 4.4 below.

4.3 Rationale for special access undertaking

FOXTEL invested in the digital service after receiving the exemption from the Commission but prior to the Tribunal's hearing. As a result, it is now bound by the s87B undertaking to give access to the Digital Set Top Unit Service in accordance with the Digital Access Undertaking and the existing DAA attached to the s87B undertaking. The current Digital Access Undertaking will expire on 31 December 2007.

However, FOXTEL no longer has the benefit of an exemption from Part XIC, even though it is currently granting access under its s87B undertaking. FOXTEL is therefore lodging a special access undertaking in order to obtain certainty about the terms and conditions (including price) on which it is required to supply access to its Digital Set Top Unit Service. This desire for certainty is consistent with the purpose of access undertakings as stated by the Commission with respect to ordinary access undertakings:

The purpose of undertakings is to give the owners/operators of facilities (including proposed or new facilities) the opportunity to remove the uncertainty as to what access conditions will apply to the service, by agreeing to certain access arrangements with the Commission in advance.¹⁴

If FOXTEL's undertaking is accepted, it will form the basis of the terms and conditions of access to the service and, if the service is declared, the Commission cannot determine terms and conditions which are inconsistent with the undertaking. In FOXTEL's experience, access arbitrations can be lengthy, expensive and, while they are on foot, prolong uncertainty in relation to the terms and conditions of access to the service. FOXTEL is concerned to avoid a situation where access disputes are notified to the Commission and no resolution is found for up to a number of years. FOXTEL is also concerned to ensure that uniform terms and conditions are applied to access to its Digital Set Top Unit Service by all access seekers.

¹⁴ Australian Competition and Consumer Commission *Access Undertakings- A Guide to Part IIIA of the Trade Practices Act (Access Undertakings – A Guide to Part IIIA of the Trade Practices Act)* p 1.

FOXTEL also seeks certainty given the highly technologically dependent nature of its services. This technology is likely to develop rapidly in the future, which will require FOXTEL to commit to ongoing investment. Consequently, FOXTEL seeks certainty in relation to the terms and conditions of access to the Digital Set Top Unit Service in order to protect its investment.

Given FOXTEL's very substantial and ongoing investment in the Digital Set Top Unit Service¹⁵, FOXTEL also seeks timely determination of the terms and conditions of access to this service, instead of waiting for the Commission to declare the Digital Set Top Unit Service and then arbitrate access disputes that may potentially arise on an ad hoc basis.

FOXTEL submits that the introduction of a digital subscription television service has brought major social and consumer benefits, has increased Australia's profile in telecommunications services, and has increased the capacity for access seekers. As FOXTEL's undertaking is consistent with the SAOs and is reasonable, FOXTEL submits that it should be accepted by the Commission.

4.4 Tribunal Decision

(a) Investment Certainty

The Tribunal rejected Seven's submissions that the s152ATA exemption route was inappropriate and that FOXTEL should have lodged a s152CBA special access undertaking. However, in assessing the exemption, the Tribunal said it must be satisfied that the exemption was in the LTIE and the only factor to be considered in assessing the LTIE was certainty in relation to investment in the digital network. The Tribunal found that that investment would have occurred even without the exemption.

The Tribunal said that it was necessary to show that the exemption would result in a positive benefit to end-users, not just that the terms and conditions of access were reasonable. There must be other favourable outcomes that were not demonstrated.

However, the Tribunal was satisfied that FOXTEL would have digitised regardless of obtaining an exemption. Consequently, the Tribunal found that as FOXTEL was already committed to giving access under the s87B undertaking, there was nothing to be gained from granting FOXTEL the exemption, and it was therefore not in the LTIE.

FOXTEL does not agree with the Tribunal's assessment of the evidence on this point and it has some serious concerns about what this will mean for future investment in new networks. In particular, it is likely to delay significantly investment as potential investors will be reluctant to begin any new infrastructure work until all potential appeals have been exhausted. This is obviously not in the LTIE. FOXTEL has outlined in detail its concerns to the Government in its recent inquiry into telecommunications.¹⁶

(b) Terms and conditions

As the Tribunal found against FOXTEL on the investment certainty issue, the Tribunal said that it did not need to deal with FOXTEL's terms and conditions. However, as some time had been spent discussing them, and it would have been relevant if digitisation was not likely to occur, the Tribunal decided to comment on them.

In this context, the Tribunal said that there were a number of terms and conditions in respect of which it had concerns. These were:

¹⁵ Approximately \$600 million.

¹⁶ FOXTEL's Response to the Telecommunications Competition Regulation *Issues Paper* April 2005.

- the exclusion of interactivity;
- CA/SI and non-FOXTEL homes;
- the term of the DAA;
- the duration of the exemption; and
- the cost-base in the pricing methodologies.

(c) Interactivity

The Tribunal was concerned that the DAA did not include access to 'interactive' services.

The Tribunal found that it was likely that 'interactive' services will be an integral part of subscription television digital services in the short- to- medium term based on overseas experience and other matters.¹⁷

FOXTEL argued before the Tribunal that FOXTEL was prepared to negotiate commercially with access seekers for these services and that the Commission could declare these services if it believed access was not being supplied in a fair manner as they were not included in FOXTEL's exemption.

While the Tribunal recognised that it was still open for the Commission to declare interactive services, the Tribunal said this was undesirable as:

- it made the digital service itself unattractive to access seekers and provided a disincentive to take the service without interactive services;
- it may make interactive services more difficult to declare; and
- it was inappropriate to have a 'piecemeal' approach to declaration and to have separate access regimes.¹⁸

(d) CA/SI and Non-FOXTEL homes

This issue concerned the requirement in the DAA that FOXTEL will only supply STU, CA and SI services to access seekers where the Digital Set Top Unit is in use by a FOXTEL subscriber (ie. FOXTEL will not supply such services to non-FOXTEL homes).

The Tribunal said that this in effect ties the availability of access to FOXTEL's basic package, and that it was unusual to insulate an access provider from competition in this manner. However, the Tribunal indicated it was:

uncomfortable with the proposition that FOXTEL should be required to provide equipment [STUs] at the behest of an access seeker while receiving no immediate benefit itself (other than access fees), even if....it was possible to ensure there was appropriate compensation.¹⁹

The Tribunal said this notion appears to depart from standard situations in which access is required.

However, the Tribunal indicated that if access seekers could obtain CA and SI services from FOXTEL separately to STUs (ie. meaning they would not be required to duplicate FOXTEL's

¹⁷ *Seven Network Limited (No 4) [2004] A Comp T 11 (Tribunal Decision)* at [283].

¹⁸ Tribunal Decision at [273].

¹⁹ Tribunal Decision at [295].

delivery infrastructure) this may be an attractive and valuable option.²⁰ The Tribunal noted that it did not receive submissions on this point and it did not refer to any evidence in support of this suggestion.²¹

The Tribunal was also concerned that an access seeker may be vulnerable to manipulation of the content of FOXTEL's basic package (although it accepted FOXTEL was unlikely to manipulate the price). The Tribunal accepted that FOXTEL's adjustment of its basic package over time may be a proper competitive response and that to prevent FOXTEL from doing so would constrain inappropriately its ability to conduct its business.²²

The Tribunal was concerned, however, that the 'tie' of the basic package to access to FOXTEL's services was a "significant deterrent to entry", particularly given that an access seeker cannot use FOXTEL's infrastructure and services other than its STUs (ie. CA and SI services).²³ The Tribunal therefore linked the issue of the 'tie' to the FOXTEL basic package to the inability to supply CA and SI services to access seekers in non-FOXTEL homes.

(e) Term of Access

The existing DAA operates for 5 years from the date the access seeker starts receiving Digital Set Top Unit Services.

The Tribunal said that there was limited information as to whether a 5 year access term was sufficient to permit reasonable prospects of entry by an efficient entrant. The only evidence the Tribunal referred to was FOXTEL's 25 year content deal, which it said suggested a longer term might be necessary in order for an access seeker to assemble a sufficiently attractive offering.

The Tribunal agreed with FOXTEL that 'reasonable' access terms do not require *profitable* entry by a given access seeker, but should allow:

an efficient [access seeker] to recover its sunk costs and to receive a reasonable return on the investment assets that underpins the product offered.²⁴

However, it said this assessment should not assume a single business model nor entry by a *particular* access seeker. Although one access seeker may not successfully enter, it may be that another access seeker could.²⁵

The Tribunal indicated it did not have sufficient evidence to conclude that a term of 5 years was reasonable.

(f) Duration of Exemption

The length of the exemption sought was tied to the length of the Digital Access Undertaking. This meant the exemption was to run until 31 December 2007 at the earliest, and could be extended by FOXTEL until 2015 (12 years). FOXTEL's s87B undertaking would remain in force as long as the exemption operated. However, existing DAAs entered into with access seekers would remain on foot until the end of their term, even if FOXTEL's exemption had expired.

The Tribunal was concerned that the exemption could be extended to 2015 because of the:

²⁰ Tribunal Decision at [298].

²¹ Tribunal Decision at [298].

²² Tribunal Decision at [299].

²³ Tribunal Decision at [301].

²⁴ Tribunal Decision at [314].

²⁵ Tribunal Decision at [315].

- unilateral nature of the extension;
- potential for rapid technological change during the course of the exemption; and
- 'magnifying' effect of the length of the extension on the Tribunal's other concerns.

The Tribunal stated that, while a long exemption may have been appropriate, it was not appropriate that the decision rest only with FOXTEL. The Tribunal was also concerned with such a long time-frame in an industry characterised by rapid technological development, particularly as it meant there could be no declaration during that period.

(g) Pricing methodology – cost base

The Tribunal indicated it was satisfied with the pricing methodology (TSLRIC) adopted by FOXTEL as modified by the Commission (including cost allocation).

The Tribunal also accepted the appropriateness of including the IBAC (the costs of the installed base of analogue customers), as the IBAC was effectively the cost of establishing the subscriber base which future access seekers would be gaining access to. It also felt that more rigorous verification of the inputs of the cost base (including IBAC and cost recovery) would be appropriate, and stated the IBAC should exclude FOXTEL – specific marketing costs.

The Tribunal also accepted the method of imputing the revenue but considered that the deemed minimum rating of 0.25% should be reviewed if more finely granulated ratings data became available.

5. Assessment of non-price terms and conditions (other than STU, CA/SI)

Both the Commission and the Tribunal commented on various of the non-price terms and conditions set out in the DAA.

FOXTEL sets out below its submissions regarding non-price terms and conditions (other than its submissions regarding access to CA and SI services - see Section 6 below).

5.1 Modem Services

In the existing s87B undertaking and DAA, FOXTEL offered access to its STUs for the provision of 'Subscription Television Services' and 'Related Services' supplied by access seekers, but not 'interactive' services.

In FOXTEL's view, there is a real question whether an interactive service that uses the modem in the STU would be declared. The ability to supply interactive services using telephones and mobile SMS is already available and, in FOXTEL's opinion, is as competitive as using the remote control linked to the STU.

Nevertheless, in the light of the Tribunal's comments about the likely future importance of interactive services, FOXTEL has decided to include in the DAA terms and conditions governing access to the modem which facilitates interactive services.²⁶ The terms of access to modem services set out in the DAA are broadly based on the terms offered to open broadcasters pursuant to FOXTEL's retransmission agreements.

(a) Modem Services vs enhanced services

There was some confusion before the Tribunal about what true interactive services entail. Given this confusion, FOXTEL has referred to the services used to deliver true interactive services in the DAA as 'Modem Services' to differentiate the services from the word 'interactive', which has developed a much wider meaning in general parlance. Similarly, FOXTEL refers to interactive content provided by access seekers as Access Seeker Modem Content.²⁷

The 'modem' is the hardware used by FOXTEL to provide interactive services that require use of a return path. It is installed in most FOXTEL Digital Set Top Unit's at the time of manufacture. Modem Services enable subscribers to view Access Seeker Modem Content via the Digital Set Top Unit, and 'interact' with that content by sending a response to the subscription television provider using the modem²⁸. These services permit the delivery of point-to-point services that use a return path and allow subscribers to participate in interactive activities such as shopping, voting, gambling and video-on-demand (a service allowing the subscriber to chose a video to watch at any time).

Modem Services are not required to enable the delivery of 'enhanced services' such as multiple player angles, different news options, player statistics and near video on demand, all of which use the forward path, and do not require the use of the modem or the return path to send signals back to the subscription television provider. These enhanced services are not interactive as no signal is transmitted from the subscriber's STU to the subscription television provider (or any one else) when

²⁶ DAA Clause 6 – Modem Services.

²⁷ DAA Clause 6; DAA Schedule 10.

²⁸ DAA Part D, Schedule 1.

the subscriber makes a selection of what to view from the alternatives provided. Rather, the subscriber is simply making a selection between information which is already being delivered to the subscriber's STU, in much the same way as a subscriber selects a particular channel. For example, Sky News Active offers 8 information screens, each of which use the forward path.

These enhanced services were already available to access seekers as 'Related Services' under the existing DAA. It is not clear that the Tribunal appreciated this fact.

(b) Elements of Modem Services

FOXTEL's modem is a standard public switched telephone network (*PSTN*) modem, currently installed in most FOXTEL Digital Set Top Units. The Modem Services that FOXTEL will supply to an access seeker comprise:

- access to the modem hardware installed within the Digital Set Top Unit;
- provision of specifications to enable access seekers to develop interactive applications specific to the channel or program being viewed;²⁹
- the ability of the Digital Set Top Unit to download interactive applications through the cable or satellite 'forward path' from the access seeker to the subscriber; and
- the ability of the Digital Set Top Unit to activate the modem to dial a number using the PSTN.

The access seeker will need to supply its own point of presence on the PSTN network to receive the customer's response from the Digital Set Top Unit via the return path (ie. FOXTEL will not be responsible for arranging for the supply of return path services). Point of presence services are widely available, and can be self-supplied or obtained from a variety of sources.

(c) Bundled with other services supplied under the DAA

FOXTEL will supply Modem Services in conjunction with other services such as STU, CA and SI services under the DAA.

FOXTEL engaged CRA to advise it on an appropriate access pricing methodology addressing the addition of Modem Services and EPG listings. CRA concluded that bundling the Modem Services Shared Costs with the STU Shared Costs and allocating them on the basis of subscription revenue (actual or imputed by reference to ratings) is the most appropriate pricing structure.³⁰ The CRA report is attached at Attachment 1.

The modem costs will therefore be included in the cost pools described in Schedule 3 to the DAA, and then allocated along with all other costs under the DAA on a revenue / ratings basis. It is not practical or reasonable to separate the costs of supplying Modem Services as most of those costs are incurred by FOXTEL in connection with the purchase and installation of the Digital Set Top Unit.

This approach best reflects the principle that costs should be allocated pro-rata among FOXTEL and access seekers according to the benefit that accrues to each user. Access seekers who may not propose to provide Access Seeker Modem Content at the time of seeking access still enjoy a benefit as they have the option of providing such a service at any time and get access to a larger

²⁹ Interactive applications are computer programs, downloaded via the forward path (cable or satellite), stored in the STU's memory, and run on its processor. They are completed each time the interactive services are launched.

³⁰ Charles River Associates: Adjusted access pricing model for digital STUs, p 17.

base of subscribers who are attracted to FOXTEL's service because of the availability of Modem Services.

As set out in CRA's report, most costs associated with supplying Modem Services comprise the costs of including the modem in the STU, and installing the STU. The costs for Modem Services can be divided into costs attributable to:

- (i) all access seekers as a group (none at present);
- (ii) an individual access seeker (for example, to carry out necessary testing and other applications); and
- (iii) both FOXTEL and access seekers.

Costs attributable to an individual access seeker (at (ii) above) will be charged directly to the access seeker.

The shared costs (at (iii) above) will be charged in accordance with the revenue/ratings structure outlined in the DAA. Shared costs will include a portion of Capex costs (comprising costs attributable to installing the return path and modem), and Opex costs (comprising engineering support, service calls, and a contribution to common costs).

By giving access to Modem Services, FOXTEL is addressing the concerns raised by the Tribunal regarding the importance of 'interactive' services.

5.2 EPG services

FOXTEL's EPG lists the various channels and programs offered on FOXTEL's service. It acts as an online information service about the channels on the FOXTEL platform. The EPG is launched by a button on the remote control, and subscribers can look at a complete list of channels, or navigate by genre.

In the existing DAA, FOXTEL agreed to negotiate in good faith the supply by it of EPG services (clause 4.2(d)), and, if the negotiations failed, the parties were to be bound by the outcome of an expert determination.

The issue of whether FOXTEL should grant access to EPG services was not discussed by the Tribunal. However, in the interests of providing greater certainty to access seekers, FOXTEL has decided to amend the DAA to provide access to EPG Services in respect of access seekers' channels, pursuant to the terms and conditions set out in the DAA³¹. EPG Services will consist of incorporating the access seeker's channel information into the FOXTEL EPG.³²

(a) Terms and conditions governing access to EPG services

Like modem services, EPG services will be provided in conjunction with the other services under the DAA. The terms and conditions governing the provision of these services include:

- the need for access seekers to provide certain information (eg date, time, title, classification and genre) in respect of all programming and channels to be included in the EPG, in specified formats and timeframes; and
- the ability of FOXTEL to allocate an access seeker's listings in the EPG according to genre, at FOXTEL's discretion.

³¹ DAA clause 5.

³² DAA Schedule 1.

(b) EPG available to subscribers

FOXTEL will only supply EPG services to an access seeker in respect of that access seeker's subscribers. This means that a particular access seeker's channels will only be listed on the version of FOXTEL's EPG viewed by the access seeker's subscribers, and not on the EPGs viewed by subscribers to other access seekers' channels, or FOXTEL channels alone. FOXTEL considers this position fair and reasonable as:

- FOXTEL bears the bulk of the costs of providing the EPG;
- the EPG is a FOXTEL-branded EPG; and
- FOXTEL should not be required to market the channels of an access seeker to its own subscribers or to other access seekers' subscribers who do not subscribe to that access seeker's channels. Rather, access seekers should undertake and pay for their own marketing activities.

(c) Position on EPG

FOXTEL has included a number of terms and conditions in the DAA that relate to the position and format of access seekers' channels on FOXTEL's EPG. FOXTEL will determine the appropriate genre for each access seeker channel, assign a channel number to it, and determine where each channel is listed on the EPG.

Like all of FOXTEL's channels, access seekers' channels will appear on the EPG, grouped by genre. For example, if an access seeker's channel relates to sport, it will be listed on the EPG with other sport channels.

The access seeker's channels will not necessarily appear on the first screen the subscriber sees when it selects the relevant genre on the EPG. Rather, the subscriber may need to navigate through the EPG to find reference to the access seeker's channel. FOXTEL considers this reasonable as:

- the FOXTEL EPG carries a large number of channels. Not all channels are able to be viewed on the 'front page' of each EPG genre;
- grouping by genre is in the interests of access seekers as it will allow viewers searching for particular types of programs to locate them easily; and
- if a subscriber has subscribed to an access seeker's channels, it is reasonable to assume that the subscriber will navigate through the EPG to find the channels he or she is paying for.

FOXTEL submits that channel location will not affect the ability of access seekers to compete against each other, or against FOXTEL. So long as an access seeker has a channel number, and the customer is made aware of and has access to that channel number (including by means of the remote control), there does not appear to be any compelling reason why channel numbering would affect the ability of an access seeker to compete.³³ Ultimately, it is access to the EPG that is important to access seekers, as opposed to channel numbering³⁴, which access is provided to access seekers pursuant to clause 5.1(a) of the DAA.

³³ Australian Competition and Consumer Commission – Final Decision on Section 152ATA Digital Pay TV Anticipatory Individual Exemption Application lodged by FOXTEL Management Pty Limited December 2003 (**ACCC – Final Decision on Digital Pay TV Anticipatory Exemption Application [Foptel] December 2003**), p. 27.

³⁴ ACCC – Final Decision on Digital Pay TV Anticipatory Exemption Application [Foptel] December 2003, p 28.

Channel numbers assigned to access seekers' channels will not necessarily be grouped consecutively within the genre listing. FOXTEL may reserve channel numbers to itself, to allow it to grow its business in the future. However, any channel numbers reserved to FOXTEL that are numbered between its current channels and an access seeker's channels will not appear on the EPG until they are used. For example, within a particular genre, FOXTEL may operate channels 201-203, reserve channels 204-209, and assign an access seeker channel 210. Until FOXTEL launches a channel using a reserved channel number, the EPG listing will simply show, in a consecutive list, channels 201, 202, 203, 204 and 210.

Access seekers are not able to reserve channel numbers. This means that, if an access seeker launches an additional channel within a genre, it will not necessarily be assigned a number consecutive to the access seeker's initial channel within that genre.

(d) Pricing allocation

CRA has produced a detailed costing methodology for EPG services in the report attached at Attachment 1. This is consistent with the methodology approved by the Tribunal, and set out in the DAA. As with modem services, EPG services will be included in the cost pools described in the DAA and apportioned amongst FOXTEL and access seekers according to the subscription revenue and ratings methodology described in Schedule 3 to the DAA. FOXTEL did consider that an alternative approach would be to allocate EPG costs for each channel (or entry) using the EPG. However, the revenue/ratings approach maintains consistency with how other costs are dealt with under the DAA and ensures that costs are apportioned according to the benefits derived by users of the services.

FOXTEL has calculated that, on current costs, in the first year the charge for EPG access will be a minimum of approximately \$5,000 (based on a channel with the minimum rating of 0.25).

5.3 Satellite amendments

In FOXTEL's current DAA, access seekers can only obtain satellite capacity from the same satellite network FOXTEL is using or a satellite using the same transmission configuration and same satellite orbital location that FOXTEL uses (essentially, the C1 satellite).

Before the Tribunal, FOXTEL offered to amend its DAA to provide access to its STUs even if the access seeker's signal is broadcast using a different satellite orbital location to FOXTEL's signal, provided the costs of enabling this are borne by the access seeker.

As FOXTEL's exemption was revoked, FOXTEL was not obliged to make that amendment to its current DAA. However, FOXTEL is now making good this offer in its special access undertaking.

This will enable access seekers to arrange for satellite carriage on another satellite slot. However, there would be additional costs involved in modifying the FOXTEL satellite equipment or installing new satellite equipment in order for the FOXTEL STU to receive the access seeker's signal. This cost would be borne by the access seeker.

FOXTEL attaches a report by Mr Bill McDonald of Australian Spectrum Consultants Pty Ltd in relation to available satellite capacity and the estimated costs of necessary satellite amendments (see Attachment 2). The report demonstrates that it is feasible to modify the FOXTEL satellite equipment in order to receive signals from satellites within approximately 10 degrees of the C1 satellite (156E).³⁵ There is currently capacity in that range.³⁶ Alternatively, a second satellite dish

³⁵ The costs are confidential and are set out in the report: Independent Export Report by Bill McDonald, Australian Spectrum Consultants, Table 8, p 35.

could be installed which would allow reception from all satellites covering Australia.³⁷ FOXTEL estimates that labour costs would be around \$100 per installation for a new satellite dish and less for modification of an existing satellite dish.

In addition, there is capacity available from Globecast and Aurora on a per channel rather than a per transponder basis.³⁸ This is also discussed in the FOXTEL Engineering Report which is attached as Attachment 5.

For those reasons, FOXTEL submits that access seekers are able to obtain satellite capacity to use in conjunction with the proposed FOXTEL Special Access Undertaking.

5.4 Term of DAA

The existing DAA commences from the Execution Date of the Agreement, and continues for 5 years from the Service Date, being the date upon which the Digital Set Top Unit Services are first supplied.

FOXTEL has amended the existing DAA to allow for terms of between 5 years and 8 years, at the access seeker's election, depending on their business model and the certainty they wish to achieve. It has also given access seekers the right to terminate the DAA on one month's notice. FOXTEL does not have a reciprocal right to terminate.

FOXTEL submits that a term of between 5 to 8 years at the access seeker's election is reasonable, and will allow an access seeker to recover its sunk costs, and make a reasonable return on its investment. This position is supported by CRA's detailed analysis of this point at Attachment 1 to this submission.

CRA finds that an appropriate term is difficult to assess due to the likely differences between access seekers' business structures, and the nature and scale of their proposed subscription television offers. However, in summary, it finds the term is reasonable as it will allow access seekers to enter the market successfully by:

- entering into content supply agreements of an average length; and
- recovering the initial costs of establishing subscription channels and a subscriber network over the period of the agreement.

The above considerations are intertwined. In order to recover sunk costs and make a reasonable return, access seekers are likely to need to enter supply agreements for broadcasting content to offer to their subscribers. In FOXTEL's experience, the average term of content supply agreements in the digital environment is 7 years (see Confidential Statement of Peter Campbell regarding the length of FOXTEL's current digital content agreements at Attachment 3). Few are longer. The evidence of the 25 year agreement before the Tribunal was unrepresentative of typical supply agreements. That agreement, between FOXTEL and the XYZ joint venture, was entered into at a time when FOXTEL was unable to source the content from anyone else, which gave FOXTEL little negotiating advantage. Therefore, FOXTEL submits that the 5-8 year term will allow access seekers to commit to content supply contracts of average length.

FOXTEL also submits that the term, together with the access seeker's power to terminate, balances the need for certainty for access seekers with recognition that, in a dynamic industry

³⁶ The details of the capacity is also confidential and set out in the report: Ibid, Table 5, p17.

³⁷ Again, the details of cost and capacity are confidential and set out in the report: Ibid., Table 5, p 17.

³⁸ Ibid, p 18, paras 36 and 37.

characterised by rapid technological change, long term contracts may be inappropriate and result in inefficiencies which may adversely affect FOXTEL's legitimate business interests.

Finally, the choice of term and termination right will allow access seekers flexibility depending on their business imperatives. Some smaller access seekers may favour the shorter 5 year period (or less if they exercise their discretion to terminate), while an 8 year term may assist others.

5.5 Other Terms and Conditions

In the context of FOXTEL's Exemption Application and s87B undertakings, a number of issues relating to other non-price terms and conditions were raised by the Commission to which FOXTEL responded. In all cases FOXTEL's response was accepted by the Commission or FOXTEL agreed to make amendments (which amendments are incorporated into the DAA). FOXTEL repeats its submissions on those matters below for the convenience of the Commission.

(a) Bank Guarantees (clauses 2 and 3)

A condition precedent to FOXTEL supplying Digital Set Top Unit Services to access seekers is that the access seeker has arranged for the issue of a bank guarantee in an amount reasonably determined by FOXTEL to be sufficient to enable the performance of the access seeker's obligations under the Digital Access Agreement. This is a typical request in any commercial relationship.³⁹

In addition, the requirement for security of some form (usually a bank guarantee) is common practice in the telecommunications industry where access to technically advanced, proprietary infrastructure is being granted. It is also commercially reasonable that FOXTEL require some form of security given that the financial position of potential access seekers is variable (they could be listed companies or small, private companies), and the potential liabilities and cost to FOXTEL of providing them with access to its infrastructure and systems are considerable.

It is not possible for FOXTEL to pre-determine the exact amount of liability and cost in respect of which it will require a bank guarantee to cover from time to time during the term of the DAA, as this will depend on the nature of each access seeker (size, financial viability etc) and the number and type of services each access seeker will require from FOXTEL during the term of the DAA.

The amount of the bank guarantee must be determined by FOXTEL, acting reasonably.

(b) Ownership of Network Enhancements (clause 9.1(b))

Under the DAA, access seekers are required to share the cost of Required Network Enhancements with other access seekers. All Network Enhancements will become the property of FOXTEL.

It is likely that the use (and the cost) of most Network Enhancements will be shared between multiple access seekers. In such cases, it would not be possible for one access seeker to assert ownership rights in relation to such shared enhancements.⁴⁰ Any enhancements specific to an individual access seeker will likely have depreciated and the cost of removing and redeploying those enhancements may be prohibitive. In addition, enhancements must meet FOXTEL's specific system specifications and therefore may be of low value for other uses.⁴¹

³⁹ Submission in support of application for an Exemption Order dated 3 January 2003, Section 4.9.

⁴⁰ ACCC – Final Decision on Digital Pay TV Anticipatory Exemption Application [Foptel] December 2003, pp 26-27.

⁴¹ ACCC – Final Decision on Digital Pay TV Anticipatory Exemption Application [Foptel] December 2003, p 27.

In addition, FOXTEL has undertaken to design that part of the network used to provide digital subscription television services to access seekers in a manner that accommodates multiple access seekers without the need for significant additional network enhancements.⁴²

(c) Operational Procedures (clauses 4.5, 4.7(d), 8.1(a) and 12(e))⁴³

Under the DAA, FOXTEL will provide access seekers with a copy of the Operational Procedures within 30 Business Days after the Commencement Date.

The Operational Procedures will not be open to negotiation with access seekers. If there is a dispute in relation to the Operational Procedures, clause 27 (dispute resolution) will only apply to disputes that relate to the compliance by an access seeker with the Operational Procedures and not the actual content of those procedures.

In addition, the Operational Procedures will apply equally to FOXTEL and access seekers, which is consistent with non-discriminatory access⁴⁴. FOXTEL also undertakes to not engage in conduct with the purpose of hindering or preventing access (see clause 4.7(c) of the DAA).

(d) Subscriber contracts (clause 14.5)⁴⁵

In FOXTEL's current subscriber contracts for its digital service, there are provisions similar to clauses 14.5(a)⁴⁶, (b)⁴⁷, (d)⁴⁸ and (f)⁴⁹. This is consistent with the principle of non-discrimination. Clauses 14.5(c) and (e) are access seeker specific subscriber conditions and are reasonably necessary to protect the commercial interests of both the access seeker and FOXTEL.

The requirement in clause 14.5(g) that the access seeker must include in its subscriber contracts any other conditions which FOXTEL may reasonably require, is limited to conditions that FOXTEL also includes in agreements with its subscribers, which is again consistent with the principle of non-discrimination.⁵⁰

(e) Liability to pay if any service interruption (clause 15.11)⁵¹

Under clause 15.11 of the DAA, access seekers are obliged to pay the relevant Access Charges and Other Payments regardless of whether or not there is any interruption in the provision of the Digital Set Top Unit Services by FOXTEL. This accords with FOXTEL's contractual relationship with its own subscribers.

However, where there has been a service interruption which continues for more than 12 hours; affects more than 25% of the access seeker's subscribers and is due to FOXTEL's failure to provide CA Services then, unless that failure is due to an event of force majeure, the access seeker will receive a credit against Access Charges. This 12 hour time period allows for scheduled

⁴² Clause 4.9 of Undertaking to the ACCC dated 21 November 2002, referred to in ACCC decision 12 December 2003, p 27.

⁴³ ACCC – Final Decision on Digital Pay TV Anticipatory Exemption Application [Foptel] December 2003, p 28.

⁴⁴ ACCC – Final Decision on Digital Pay TV Anticipatory Exemption Application [Foptel] December 2003, p 28.

⁴⁵ ACCC – Final Decision on Digital Pay TV Anticipatory Exemption Application [Foptel] December 2003, pp 28-30.

⁴⁶ FOXTEL Digital Subscription Agreement, effective from 22 February 2005 (*Foptel Digital Subscription Agreement*) pp 2-3.

⁴⁷ Foptel Digital Subscription Agreement pp 14-15.

⁴⁸ Foptel Digital Subscription Agreement p 4.

⁴⁹ Foptel Digital Subscription Agreement pp 4-5.

⁵⁰ ACCC – Final Decision on Digital Pay TV Anticipatory Exemption Application [Foptel] December 2003, pp 29-30.

⁵¹ ACCC – Final Decision on Digital Pay TV Anticipatory Exemption Application [Foptel] December 2003, pp 31-32.

maintenance and only applies in circumstances of clear disruptive network failure which FOXTEL believes is appropriate.

While access seekers are free to choose how they wish to allocate this service interruption risk – whether they offer their subscribers a refund for any interruption or not – it is not reasonable for FOXTEL to be in a significantly worse position as regards access seekers than it is with its own subscribers. FOXTEL requires its subscribers to continue to pay subscription charges in the event of service interruption because during periods of interruption, FOXTEL continues to incur costs itself. In addition, most interruptions are not caused by FOXTEL. FOXTEL would expect that access seekers would have similar provisions in their subscriber contracts, which would mitigate service interruption risks for them.

Even if the access seeker does not include such a clause in its subscriber contracts, the access seeker will not be disadvantaged as its access charges are based on its actual revenue or ratings. If it does not receive revenue from subscribers or ratings in relation to its service, it will only pay the minimum access charge to FOXTEL, based on 0.25% rating. In contrast, FOXTEL will continue to incur costs with no decrease in its access 'charge', and may in fact incur additional costs if the access seeker is paying less.

In any case, FOXTEL does not believe that any service interruption to the network is likely to be caused by FOXTEL. Rather, it is likely to be a carriage issue related to the quality of the cable or satellite signal.

For these reasons, FOXTEL considers it appropriate and reasonable that access seekers be liable to pay FOXTEL access charges in the event of any service interruption. Clearly, FOXTEL will have a strong commercial incentive to remedy any interruption as quickly as possible, in particular given that each access seeker customer will also be a FOXTEL subscriber.⁵²

FOXTEL is also obliged to provide the services to an access seeker to the equivalent quality as it provides those services to itself (clause 4.1(b)). It is in FOXTEL's interest to avoid significant service interruptions. If an access seeker believes they should not be charged in relation to an interruption, then they may dispute the relevant invoice (either under clause 15.6 or 15.7). Further, in the event of any interruption, FOXTEL itself must continue to pay its costs and receives no relief from its payments. Therefore, the standard for each is the same and there is no discrimination between FOXTEL and access seekers in this regard.⁵³

So far as access to individual STUs is concerned, it would be impractical to provide a reduction in the Access Charge calculated by reference to the fact that access to a small number of individual STUs may be interrupted for particular periods of time because of some fault in the STUs. Given that FOXTEL will be installing new or rebirthed STUs, the level of faults is likely to be low, and the administrative costs of calculating any reduction in the Access Charge are likely to far outweigh the amount of the reduction itself. To take a simple example (which FOXTEL believes substantially exaggerates the level of faults), suppose an access seeker pays \$2 million per annum for access. Suppose also that in any one year there is a fault with 1 in 100 STUs and that it takes, on average, 3.65 days to repair those faults. Theoretically, the access charge could be reduced by \$2 million x 0.01 x 3.65/365 – that is, \$200. Clearly, the costs of collecting all the relevant information to calculate the precise reduction would not be justified.

⁵² ACCC – Final Decision on Digital Pay TV Anticipatory Exemption Application [Foptel] December 2003, pp 31-32.

⁵³ ACCC – Final Decision on Digital Pay TV Anticipatory Exemption Application [Foptel] December 2003, p 31.

Moreover, a reduction which is calculated by reference to the full Access Charge to a particular STU would not be reasonable, for two reasons. First, the access charge is payable for access to STUs and to the conditional access system. In circumstances where access is still available to the conditional access system, the proportion of the access charge which relates to that service should not be reduced. Secondly, one benefit the access seeker obtains from access is access to an installed subscriber base. It continues to obtain that benefit even if access to particular STUs is temporarily interrupted.

(f) Payments – billing inquiries (clause 15.5(b))⁵⁴

Under clause 15.5(b) of the DAA, FOXTEL will respond to billing enquiries from access seekers as soon as reasonably practicable.

Responding to an access seeker's billing enquiries "*as soon as reasonably practicable*", is a commercially reasonable position and provides an objective standard upon which billing enquiries may be dealt with given that:

- billing enquiries may relate to third party payments that have been passed through on an access seeker invoice, where FOXTEL may need to seek information from such third parties; and
- billing enquiries may be complicated, requiring FOXTEL to undertake extensive investigation.

(g) Payment – incorrect payment and retrospective charges (clauses 15.6 and 15.9)⁵⁵

Under clause 15.6 of the DAA, if an invoice has been rendered incorrectly, FOXTEL will promptly refund any over-payment and the access seeker will promptly pay any under payment.

Under clause 15.9 of the DAA, FOXTEL may invoice access seekers for payments not previously invoiced, provided that the payments to be retrospectively invoiced can be substantiated by FOXTEL, and in relation to Access Charges revealed following an Audit, they are invoiced within 20 Business Days of the date of completion of the relevant Audit.

The timeframes in clauses 15.6 and 15.9 are necessarily different given the differences in access to the information required to correct payments and the ability to make such corrections.

Clause 15.6 relates to where an invoice has been incorrectly rendered and an access seeker has made a payment to FOXTEL. The access seeker has 40 business days after payment to notify FOXTEL of a dispute, otherwise it may not dispute the amount. It is likely that access seekers would raise most invoice disputes prior to making a payment, so any corrections would occur at an earlier stage. It is also likely that access seekers, if there was any doubt as to the validity of an invoice (or part thereof), would raise a dispute. This could be done even if an access seeker sought no further information in relation to the dispute. In any event, access seekers would have the benefit of the audit provisions in clause 15.13. In particular, clause 15.13(f), which requires the parties to make adjustments to payments resulting from any differences arising from the audit within 20 days of the date of the audit.

Clause 15.9 relates to where FOXTEL seeks to invoice an access seeker retrospectively for:

- access charges revealed following an audit (an audit being the only way FOXTEL can verify access charges, as such charges are based on an access seeker's subscription

⁵⁴ ACCC – Final Decision on Digital Pay TV Anticipatory Exemption Application [Foptel] December 2003, p 30.

⁵⁵ ACCC – Final Decision on Digital Pay TV Anticipatory Exemption Application [Foptel] December 2003, pp 30-31.

television services revenues) in which case FOXTEL must notify the access seeker within 20 days of the audit; or

- other payments, including third party pass through payments (provided that these are invoiced within a reasonable time after they are incurred or payable by FOXTEL).

In both these instances, FOXTEL may need information from third parties before it is able retrospectively to invoice an access seeker.

(h) CPI provisions (clause 15.12)

In the context of FOXTEL's Exemption Application, Channel Seven also raised a concern about the CPI clause. Under clause 15.12 of the DAA the Access Charges and Other Payments set out in the DAA are exclusive of GST and the Other Payments may be increased each year with reference to CPI.

The CPI provisions only apply to "Other Payments" and not "Access Charges". These are the miscellaneous fees able to be charged under the DAA for additional services provided to access seekers. Although the CPI provision does not contemplate negative CPI, FOXTEL submits that the risk of negative CPI is unrealistic, and that a CPI provision in the terms set out in the DAA is standard commercial practice and commercially reasonable.

(i) Defamation (clause 18.3(a)(ii))⁵⁶

The list in clause 18.3(a)(ii) is non exhaustive. An access seeker's use of the Digital Set Top Unit Services must comply with *all* laws, including those in relation to defamation. It is fair and reasonable that FOXTEL require a warranty in respect of defamation laws because although the access seeker alone has control over the content of its service, FOXTEL is potentially a 'publisher' for defamation law purposes of any matter broadcast on or by that service.

(j) Liability (clause 23)⁵⁷

Clause 23 of the DAA sets out the limitations on FOXTEL's liability under the DAA. It also states those acts which are excluded from the limits of liability.

It is commercially reasonable and usual for a service provider to limit their liability in the manner proposed by FOXTEL in clause 23 of the DAA.

(k) Immediate termination by FOXTEL (clause 24.2(f))⁵⁸

Under clause 24.2(f) of the DAA, if the Access Seeker ceases to be a party to an arrangement with a Carriage Service Provider for the supply of a Subscription Television Digital Carriage Service, and there are constraints on the capacity available to FOXTEL to supply Digital Set Top Unit Services to itself or other access seekers, FOXTEL may immediately terminate all or any part of the DAA.

Digital Set Top Unit Services cannot be provided to an Access Seeker who does not have access to the required carriage services⁵⁹ or ceases to hold a subscription television licence under the BSA. FOXTEL submits that its right to terminate the DAA immediately in these circumstances is reasonable.

⁵⁶ ACCC – Final Decision on Digital Pay TV Anticipatory Exemption Application [Foptel] December 2003, p 33.

⁵⁷ ACCC – Final Decision on Digital Pay TV Anticipatory Exemption Application [Foptel] December 2003, p 32.

⁵⁸ ACCC – Final Decision on Digital Pay TV Anticipatory Exemption Application [Foptel] December 2003, p 34.

⁵⁹ ACCC – Final Decision on Digital Pay TV Anticipatory Exemption Application [Foptel] December 2003, p 34.

The other circumstances in which FOXTEL may immediately terminate the provision of the Digital Set Top Unit Services or the DAA are commercially reasonable (eg. if the Access Seeker fails to remedy a breach of the DAA, becomes insolvent and is unable to pay for the services being provided by FOXTEL).

In addition, the Access Seeker also has the right to terminate the DAA or the supply of the Digital Set Top Unit Services immediately if FOXTEL fails to remedy a breach of the DAA or becomes insolvent).

Access seekers may also terminate the DAA or the supply of the Digital Set Top Unit Services at any time with one month's notice.

(I) Dispute resolution procedures (clause 27)⁶⁰

FOXTEL has provided a clear dispute resolution mechanism that incorporates both mediation and, in relation to technical matters, binding expert determination, prior to a party commencing arbitration or court proceedings (except in relation to interlocutory relief).

The DAA also provides for the establishment of a working group made up of representatives of the parties (the Access Technical Implementation Group) responsible for coordinating the implementation of the access agreement and coordinating ongoing technical issues (see clause 26.1 of the DAA).

FOXTEL has always intended that an access seeker may dispute the amount of charges levied on it in relation to Required Network Enhancements *ex post* or *ex ante*, provided that any dispute is genuine and FOXTEL itself is not required to bear the cost of any access seeker-required extension or maintenance of that extension.

In addition, access seekers can dispute payments or charges with respect to Required Network Enhancements pursuant to clause 15.7 of the DAA.

FOXTEL submits that these dispute resolution mechanisms promote the LTIE and that the dispute resolution procedures relating to technical disputes and Required Network Enhancements are adequate.⁶¹

⁶⁰ ACCC – Final Decision on Digital Pay TV Anticipatory Exemption Application [Foptel] December 2003, p 34-37.

⁶¹ ACCC – Final Decision on Digital Pay TV Anticipatory Exemption Application [Foptel] December 2003, pp 35-37.

6. Provision of STU services to FOXTEL homes only

6.1 Nature of Restriction

The DAA contains a condition that FOXTEL's STUs and ancillary services can only be used by an access seeker where the STU is in use by a FOXTEL subscriber. Clause 4.1 provides that:

- (c) FOXTEL is only obliged to supply and continue to supply Digital Set Top Unit Services to the Access Seeker:
 - (i) ...where the Digital Set Top Unit to which the Digital Set Top Unit Services are to be supplied is actually in use by a Subscriber for reception of FOXTEL's digital Subscription Television Services
- ...
- (f) FOXTEL has no obligation to supply any of the Digital Set Top Unit Services to a location where the Digital Set Top Unit to which the Digital Set Top Unit Services are to be supplied is not in use by a Subscriber for reception of FOXTEL's digital Subscription Television Services...

Therefore, Digital Set Top Unit Services are only offered by FOXTEL where the particular Digital Set Top Unit is being used by a FOXTEL subscriber. As FOXTEL only supplies its STUs when a subscriber connects to the FOXTEL service, the subscriber must take FOXTEL's basic package to be provided with an STU, which can then be used for both FOXTEL and access seekers' services.

Similarly, FOXTEL is not obliged to continue providing Digital Set Top Unit Services to a person who ceases to be a FOXTEL subscriber. In those circumstances, FOXTEL is entitled to remove its Digital Set Top Unit from the subscriber's house, even if the subscriber still wishes to receive an access seeker's service. Clause 11.1 provides:

11.1 The Access Seeker acknowledges and agrees that:

- ...
- (d) nothing in this Agreement limits FOXTEL's rights at Law or under an agreement with its Subscribers to demand that the Subscriber return the Digital Subscriber Equipment, to remove any Digital Subscriber Equipment from Subscriber Premises or otherwise to deal with the Digital Subscriber Equipment, including upon that Subscriber ceasing to Subscribe to FOXTEL's digital Subscription Television Service;
- (e) FOXTEL will have no liability to the Access Seeker if FOXTEL exercises the rights referred to in clause 11.1(d);
- ...

However, this right is limited by clause 11.5, which provides:

- (a) FOXTEL must not remove any Digital Subscriber Equipment from Subscriber Premises by reason solely of the fact that the Subscriber is receiving digital Subscription Television Services from the Access Seeker.
- (b) FOXTEL must give to the Access Seeker such notice as is reasonably practicable having regard to FOXTEL's usual business practices of FOXTEL's intention to remove a Digital Set Top Unit from a Subscriber Premises.

FOXTEL is thus prevented from discriminating against subscribers to an access seeker's service solely because of this subscription. FOXTEL can only remove the STU for usual business reasons - for example, if the subscriber voluntarily disconnects from FOXTEL or the subscriber is

involuntarily disconnected from FOXTEL due to a breach of relevant terms and conditions, such as non-payment of fees or damage to the STU.

If the subscriber wishes to continue to receive the access seeker's service once it disconnects from the FOXTEL service, it will be up to the access seeker to supply the subscriber with an STU.

FOXTEL has investigated at length the feasibility of providing access seekers with STUs, in non-FOXTEL homes, or unbundling CA and SI services and providing those to access seekers using their own STUs in non-FOXTEL homes. FOXTEL has found overwhelming technical and operational difficulties associated with providing those services, substantial costs to FOXTEL, and a significant risk of under-recovery. It is FOXTEL's submission that these risks and difficulties outweigh any potential benefit from FOXTEL providing a full or unbundled service to non-FOXTEL homes, in circumstances where access seekers are able to provide those services themselves in non-FOXTEL homes. These risks and difficulties are discussed further below.

FOXTEL submits that the above position is reasonable and consistent with the standard access obligations.

FOXTEL attaches at Attachment 4 another report from CRA, which discusses the reasonableness of FOXTEL restricting the supply of Digital Set Top Unit Services to non-FOXTEL homes from an economic point of view.

FOXTEL also attaches at Attachment 5 an Engineering Report which sets out the technical issues associated with FOXTEL supplying STUs, CA and SI in non-FOXTEL homes and assesses the various different options available to access seekers.

6.2 Not reasonable to force FOXTEL to supply STUs to non-FOXTEL home

FOXTEL submits that it would not be reasonable or consistent with the principles of Part XIC of the Act to compel FOXTEL to supply STUs to non-FOXTEL homes. FOXTEL submits that any benefit that may be derived from FOXTEL supplying STUs is clearly outweighed by the costs and inefficiencies which would result.

CRA concludes that if FOXTEL was forced to supply STU services in non-FOXTEL homes, it is likely that:

- entry barriers would not be reduced;
- very significant costs would be incurred with no assurance of recovery;
- there would be no clear efficiency gains; and
- FOXTEL's ability to recover and gain a return on its investments would be compromised.⁶²

(a) FOXTEL's business model is reasonable and consistent with industry practice

FOXTEL's commercial business model is based on FOXTEL owning⁶³ the STU and providing the STU to its subscribers. FOXTEL does not propose to change this model at this stage.

It is important that FOXTEL be able to supply STUs to subscribers for a number of reasons:

⁶² Henry Ergas, Charles River & Associates: Reasonableness of Limiting the Supply of FOXTEL's Conditional Access Service, p58

⁶³ FOXTEL's STUs are the subject of sale and leaseback arrangements under which ownership reverts to FOXTEL at the end of the lease.

- to subsidise the cost of the STU and reduce the upfront cost to the subscriber in order to encourage subscriptions;
- to encourage customers to subscribe to FOXTEL's digital subscription television services by removing any perceived risk that the subscriber may be investing in technology that may become outdated or cheaper in the future;
- to enable FOXTEL to upgrade its technology by software downloads to the STU on a regular basis at no cost to the subscriber, and by replacing the physical STU at the end of its service life, making the platform more attractive to subscribers and content providers;
- to enable FOXTEL to monitor the specifications of the STUs and the quality of their installation to ensure consistent and quality reception;
- given the STUs are single purpose devices, FOXTEL can redeploy the STUs on churn rather than leave unused STUs in lapsed subscribers' homes. As churn is a common feature of the subscription television industry, and because the useful life of the STU (approximately 5-7 years) exceeds the average life of a FOXTEL subscription, such redeployment is typical. For these reasons, continued ownership of the STU by FOXTEL reduces the cost of serving new customers, and is more economically efficient; and
- FOXTEL operates in a relatively infant and underpenetrated market – consequently it is important for FOXTEL to act as a 'market maker' for STUs as it cannot rely on alternate sales channels for STUs to stock STUs in the quantity and across the geographic range necessary for FOXTEL to reach its growth targets.

These considerations, as well as those discussed below illustrate the genuine practical, technological and commercial reasons for FOXTEL to 'tie' the provision of its STUs with the provision of its retail service. FOXTEL submits that it would be unreasonable and without precedent for the ACCC to compel FOXTEL to change this aspect of its business model.

(b) Technical and operational difficulties with supplying STUs

FOXTEL would face significant technical and operational issues if it were compelled to supply Digital Set Top Unit Services to non-FOXTEL homes.⁶⁴

As a matter of commercial reality, FOXTEL is a provider of subscription television services, not a supplier of STUs. Requiring FOXTEL to become a third party supplier of STUs would impose obvious business risks and costs on FOXTEL.

FOXTEL would need to modify its operations significantly in order to accommodate the supply of these services to non-FOXTEL homes. These modifications are set out in Figure 5 of the Engineering Report.⁶⁵

In essence, FOXTEL would need to separate its subscriber management systems and create a separate access seeker STU provision business division in order to provide ordering, warehousing, inventory, calendar, installation and STU provision services to access seekers for non-FOXTEL homes. The Active Customer Smartcard Database (**ACSD**) would also need to be modified to enable it to include smartcard numbers that are not linked to an active FOXTEL subscriber, as currently the ACSD only includes active, FOXTEL smartcards. This would create real difficulties in the FOXTEL system in respect of tracking and managing such smartcards/STUs as the FOXTEL

⁶⁴ Engineering Report, Section 6.1.4.

⁶⁵ Engineering Report, Section 6.1.4.1.

system would not recognise the subscriber, nor would FOXTEL have a contractual relationship with the subscriber.

FOXTEL submits that the upfront and ongoing costs it would need to incur to modify the system would be significant, and would have to be borne by access seekers.⁶⁶ Even if that were possible, FOXTEL may be exposed to liabilities in relation to access seeker subscribers from non-FOXTEL homes, and it may bear some unacceptable risks on behalf of the access seekers in relation to the costs of purchasing, inventory, management of and installing STUs.

FOXTEL would also need to obtain sub-licences in respect of all third party intellectual property in the STUs, CA and SI, which would most likely need to be done on a case-by-case basis (at the insistence of the IP rights holder).⁶⁷ FOXTEL would also need to be properly indemnified in relation to any claims associated with use of such intellectual property.

(c) Cost of Supplying STU Services

It is impossible to predict all of the costs that would be involved if FOXTEL were compelled to provide full STU services to access seekers for non-FOXTEL homes. FOXTEL would need to be fully compensated for these incremental costs and, in addition, receive a contribution towards its costs of developing the STU and related services which the access seeker receives the benefit of. As FOXTEL does not receive any revenue from these homes, this cost is likely to be closer to the stand-alone cost of the access seeker supplying the service to itself. FOXTEL would need some form of financial comfort or a facility to secure itself against these costs, from which it could deduct its ongoing costs. These costs would include:

- the cost of purchasing the STUs themselves (for which FOXTEL would need to be paid in advance to eliminate risk to it in purchasing those STUs);
- the costs of retrieving STUs which are not returned by its subscribers;
- refurbishment charges related to subscribers' STUs; and
- the costs of equipment FOXTEL has previously installed (such as non-branded fly cables and wall plates).

As the access seeker will need to compensate FOXTEL both upfront and on an ongoing basis, FOXTEL is concerned that an attempt to recover all of the above costs may lead to ongoing disputes. This may in turn mean FOXTEL would incur risk on the debts owed by the new business division.

There are also real issues as to how the costs should be calculated and the inventory managed, for example:

- Should the access seeker have a separate physical inventory from which to draw its STUs, and if so, how should this be managed?
- If not, how does FOXTEL 'reimburse' the access seeker where an STU that is fully paid for is disconnected from a subscriber and put into the pool of STUs (bearing in mind that if that STU is not reused by the access seeker, it should not be at FOXTEL's risk)?

⁶⁶ Under s152CQ(1)(f) of the Act, an access provider cannot be required to bear an unreasonable amount of the costs of extending or enhancing the capability of a facility or maintaining such extensions or enhancements.

⁶⁷ Engineering Report, Section 3.2.

- How are 'churned' subscribers dealt with ie if an access seeker's subscriber also elects to take FOXTEL, how does FOXTEL 'reimburse' the access seeker if the access seeker then elects to pay FOXTEL as under the DAA? How are the installation costs incurred by the access seeker dealt with in this scenario?
- What happens to the STUs if the access seeker goes out of business?

Attached at Attachment 6 is a report by Dr Philip Williams on market definition and the promotion of competition. Dr Williams concludes that it is unlikely that any access seekers will develop a full subscription television service competing with FOXTEL's basic package. Consequently, it is unlikely that, if this option were available, anyone would take advantage of it. In these circumstances, it would be unreasonable to compel FOXTEL to go to the cost and effort of modifying its system so that it was able to provide STUs in non-FOXTEL homes. Any minimal benefit that might be gained from FOXTEL providing these services is outweighed by the cost, particularly given that it is still possible for access seekers to provide the services themselves if, contrary to the conclusions of Dr Williams, there really is a demand for them.

(d) Access seekers can provide own STUs

Under the proposed special access undertaking access seekers have a choice of:

- relying on the FOXTEL DAA and only supplying a service in a FOXTEL home⁶⁸; or
- if access seekers wish to provide 'basic' services rather than services available as a tier on the FOXTEL basic, they can:
 - use the FOXTEL DAA in FOXTEL homes and supply their own STUs, CA and SI services in non-FOXTEL homes; or
 - roll out their own STUs, CA and SI into all homes (and therefore not seek access to FOXTEL at all).

Access seekers can source their own carriage from Telstra under the Telstra Multimedia Access Agreement, or from another carriage provider, independently of seeking access under FOXTEL's DAA. The Telstra Access Agreement allows for a subscriber to use either FOXTEL STUs or the access seeker's own STUs.⁶⁹ FOXTEL has also undertaken to the Commission to consent to an access seeker connecting to, adapting or altering the FOXTEL equipment installation in order to install its own STUs and associated equipment in FOXTEL homes provided that:

- the access seeker complies with FOXTEL's reasonable and legitimate business requirements regarding safety, signal quality, network integrity and interference;
- the access seeker gives appropriate warranties and indemnities; and
- FOXTEL obtains necessary consents from the third party lessor of the Digital Set Top Units.⁷⁰

Digital STUs are freely available to purchase and range from relatively low cost, low feature STUs to high-cost, full feature STUs (like the FOXTEL STUs).⁷¹ Different STUs may suit different access seekers depending on their needs, business model and budget. Access seekers can also set up

⁶⁸ Engineering Report, Section 6.1.1.

⁶⁹ Telstra Multimedia Access Agreement, Clause 6 .

⁷⁰ Section 87B Undertaking at clause 23.2 .

⁷¹ Engineering Report, Section 6.1.2(c).

their own conditional access system or license one from a third party, again ranging from a basic system to a full feature system.⁷² A bundled carriage, CA and SI service may also be available to acquire from some third parties (eg Globecast on satellite and Telstra on cable).⁷³

If access seekers choose to use the FOXTEL DAA for STUs in FOXTEL homes *and* provide their own STUs, CA and SI in non-FOXTEL homes, access seekers will need to purchase capacity equivalent to two channels for each channel they wish to distribute.⁷⁴ This is because the FOXTEL's CA/SI and the access seeker's CA/SI will be different and cannot be delivered in one programming stream. This is the case even if they are developed to the same specification. The only way in which this cost could be avoided is if the programming streams are simulcrypted (so that two or more CA streams are carried). However, simulcrypting is not a viable option in a scenario with multiple access seekers.⁷⁵

In FOXTEL's view the cost of purchasing additional channel capacity is reasonable as the access seeker is still receiving a large benefit from using FOXTEL STUs in FOXTEL homes, rather than installing its own STUs. The access seeker would be utilising two different networks – FOXTEL's and its own – in the same way that FOXTEL uses two different networks and pays for capacity on each (ie. cable and satellite). Alternatively, access seekers can choose to roll-out their own STUs, CA and SI in all homes if this is more cost-effective.

FOXTEL therefore submits that the restriction on FOXTEL supplying services to FOXTEL homes does not prevent access seekers from competing with FOXTEL in the provision of subscription television services. FOXTEL submits that it is likely that most competition will be in the tiering on FOXTEL's service. However, consumers can subscribe to the access seeker's service in non-FOXTEL homes, provided the access seeker is willing to install an STU in the subscriber's home. This is consistent with the Commission's decision in relation to the analogue service.⁷⁶

(e) Conclusion

In FOXTEL's view, if FOXTEL were compelled to supply STUs to non-FOXTEL homes, the number of access seekers that would request FOXTEL to do so is likely to be extremely low, or even zero, as the cost of FOXTEL providing the services (payable by the access seeker) is likely to be equivalent to the cost of the access seeker providing the services itself.

Given the potential for access seekers to compete with FOXTEL as a tier using its DAA or, with FOXTEL's basic package by installing their own STUs, CA or SI (either in conjunction with the DAA or stand-alone), FOXTEL submits that any benefit that might be gained from FOXTEL providing these services is outweighed by the costs.

Requiring FOXTEL to supply Digital Set Top Unit Services to all homes would also give an unjustified benefit to the 'second in time', to the detriment of the 'first in time'. FOXTEL submits that it would discourage future investment if a service provider knew it may be required to roll-out further infrastructure solely for the use of an access seeker, without receiving any benefit .

It may also hinder innovation in STUs as access seekers may rely on FOXTEL's innovations rather than developing their own to compete with the FOXTEL STU. It may also impact FOXTEL's

⁷² Engineering Report, Section 6.1.2(d).

⁷³ Engineering Report, Section 6.1.2(a) and (b).

⁷⁴ Engineering Report, Section 6.1.2.

⁷⁵ Engineering Report, Section 6.1.2(e).

⁷⁶ ACCC Report – Analogue Pay TV Access Undertaking [Foxtel], p 43.

motivation to innovate as FOXTEL may be reluctant to give access seekers the benefit of technological advancements it makes to STUs if they are to be installed in non-FOXTEL homes.

These problems were expressly recognised by the Tribunal in its decision. For these reasons the Tribunal indicated that it was unlikely to be appropriate to compel FOXTEL to supply STUs to non-FOXTEL homes.

In these circumstances, FOXTEL submits that the Commission would not require FOXTEL to supply Digital Set Top Unit Services to non-FOXTEL homes.

6.3 Not reasonable to force FOXTEL to unbundle CA and SI

FOXTEL also submits that the technical and operational inefficiencies and difficulties associated with 'unbundling' CA and SI and supplying CA and SI services to access seekers who supply their own STUs (as suggested by the Tribunal) also outweighs any benefits of doing so.

CRA concludes that compelling FOXTEL to supply CA and SI services to non-FOXTEL homes is unreasonable as it is likely:

- entry barriers would not be reduced or reduced only slightly;
- significant costs would be incurred by FOXTEL with no assurance they will be recovered;
- unbundling CA/SI may reduce and distort competition;
- there would be no clear efficiency gains and in particular, innovation and service upgrading would become substantially more difficult; and
- FOXTEL's ability to recover and gain a return on its investments would be compromised.⁷⁷

(a) Technical and operational issues

The Engineering Report outlines the technical and operational issues that would be involved if FOXTEL was to 'unbundle' CA and SI and supply those services to access seekers in non-FOXTEL homes.⁷⁸ These issues include the following:

- an access seeker's STU would need to be compatible with the FOXTEL STU at all times (which in essence would require it to be identical in all material respects with the FOXTEL STU) otherwise the access seeker's STU would become unstable and eventually fail to decode FOXTEL signals;
- access seekers STUs would need to be managed as if they were FOXTEL STUs, and would need to be tested and upgraded at the same time as the FOXTEL STUs;
- a high level of cooperation between FOXTEL and the access seeker would be necessary, which may be difficult given that they are competitors;
- management of different versions/variants of compatible STUs would become very expensive, complex and time-consuming;
- increased bandwidth would be needed for management and support; and
- any conflicts may lead to one or both platforms stalling in their development and impacting on all users (and subscribers).

⁷⁷ Henry Ergas, Charles River & Associates: Reasonableness of Limiting the Supply of FOXTEL's Conditional Access Service, p25

⁷⁸ Engineering Report, Section 6.1.3.

In addition to these technical and operational issues, providing CA and SI services to access seekers in non-FOXTEL homes would require several significant modifications to FOXTEL's systems, including:

- redesigning the ACSD;
- changing FOXTEL's STU tracing and field installation/maintenance databases;
- the establishment by FOXTEL of smartcard purchase management; and
- changes to FOXTEL's testing facilities.⁷⁹

This would essentially require establishment of a wholesale division with dedicated personnel who have responsibility for managing provision of services to access seekers. The costs of this division would have to be borne by access seekers.

(b) Costs to access seekers

In addition to the costs of modifying FOXTEL's system, access seekers would have to compensate FOXTEL not just for the incremental cost of supplying them with the service but a contribution to the cost of developing the CA/SI service (and the STUs) which the access seeker obtains the benefit of.

As FOXTEL does not receive any revenue from supplying the service to the non-FOXTEL homes, this cost is likely to be closer to the stand-alone cost of access seekers supplying the service themselves. In these circumstances, it would be more economically efficient for access seekers to supply the service, particularly, as discussed in Dr William's report, there are unlikely to be any full service access seekers.

(c) Efficiency Issues

As discussed above, if FOXTEL were compelled to unbundle its CA/SI services, non-FOXTEL STUs used by access seekers would need to be identical in all major respects to the FOXTEL STU to ensure compatibility with the FOXTEL CA and SI systems.

Therefore, access seekers would have to purchase an STU to the same technical specification of FOXTEL's STU regardless of the functionality that the access seeker needed to provide its service. This may increase costs for access seekers who do not need the same level of functionality as FOXTEL.

Whilst technically the access seeker's STU could be used for both access seeker and FOXTEL services, in reality this perceived 'efficiency' is illusory. The access seeker has no obligation to give FOXTEL access to its STU, nor can FOXTEL be forced to use that STU. This was noted by the Commission in the decision relating to the analogue undertaking:⁸⁰

The Commission notes that the provision by FOXTEL of its STU specifications to an access seeker would not, of itself, guarantee that FOXTEL would provide its content through STUs other than its own. As FOXTEL content is not part of the declared service, FOXTEL cannot be required to offer such a service by an undertaking or an arbitration determination. It is therefore not clear to the Commission that access seekers or the competitive process would be assisted by a requirement that FOXTEL disclose its STU specifications to access seekers.

Given that the Commission cannot require FOXTEL to provide its content service, the Commission considers that the simplest solution...is that access seekers should install their own STUs in the

⁷⁹ Engineering Report, Section 6.1.3.1.

⁸⁰ ACCC Report – Analogue Pay TV Access Undertaking [Foptel] p 42.

homes of new...subscribers as they see fit and without regard to whether those STUs can receive a FOXTEL service or not. In the event that such a subscriber should want to also receive a FOXTEL service in the future, it would be open to the access seeker to inform the subscriber to inform FOXTEL that it wishes to receive the FOXTEL service and that FOXTEL could install its own STU. It would then be up to the access seeker to decide if it wished to remove its STU or use the FOXTEL STU for the supply of its service to that customer.

Currently, other STU providers do not have any obligation to supply access to their STUs. Working out a reciprocal arrangement for access to those STUs raises many difficult issues. Even if the Commission declared STU services so that other providers of STUs were compelled to grant access to them, the Commission could not compel FOXTEL to use those STUs instead of its own. Content services cannot be declared by the Commission under Part XIC as they are not 'eligible services' (not being listed carriage services or services which facilitate the supply of listed carriage services).

This means that, when an access seeker subscriber using an access seeker's STU wishes to become a FOXTEL subscriber, FOXTEL will install a FOXTEL STU. It will then be at the access seeker's election whether it wishes to remove its STU and deliver its content through the FOXTEL STU or whether it wishes to continue to use its own STU (so that the subscriber has two STUs).⁸¹

Consequently, there are no additional efficiencies to be gained from access seekers using FOXTEL's CA/SI and a compatible STU.

(d) Access seekers can supply their own CA and SI

FOXTEL submits that access seekers can supply their own CA and SI services as well as supplying STUs in non-FOXTEL homes. In this regard, FOXTEL refers to the Engineering Report.⁸²

FOXTEL submits it may be in access seekers' interests to source and supply their own CA and SI services to meet their own business needs, rather than paying for use of the high-end FOXTEL CA/SI services. Access Seekers also have the ability to purchase bundled carriage, CA and SI services on satellite from providers such as Globecast.⁸³

(e) Conclusion

FOXTEL submits that the costs and technical issues that would arise from unbundling CA and SI services outweigh any possible benefit to competition. The provision of these services does not remove a major barrier to entry as access seekers retain the ability to enter with their own CA and SI systems, and the technical and operational difficulties outweigh any possible benefit.

6.4 The Commission does not have power to force FOXTEL to supply STUs, CA or SI

In any event, FOXTEL submits that the Commission does not have the statutory power to compel FOXTEL to supply STUs or unbundled CA/SI services to non-FOXTEL homes.

If the Digital Set Top Unit Service were declared, FOXTEL would not be obliged to supply Digital Set Top Unit Services (or any part of them) in non-FOXTEL subscriber locations. FOXTEL submits this conclusion follows plainly from an analysis of Part XIC.

⁸¹ Engineering Report, Section 6.1.3.2.

⁸² Engineering Report, Section 6.1.2.

⁸³ Engineering Report, Section 6.1.2(a) and (b).

(a) Supply of STUs to non-FOXTEL homes

STUs are not "carriage services" nor "services that facilitate the supply of carriage services" under s152AL(2). They are therefore not services that can be declared in their own right. Rather, access to STUs is caught under s152AR(8) as conditional – access customer equipment. If an access provider supplies a "declared" service by means of STUs it must supply to an access seeker any service necessary to enable the service provider to supply carriage services or content services *using the equipment*. Thus, the obligation only arises in relation to the *STUs* used by the access provider and does not require it to supply STUs that are not in use by it.

Part XIC does not give rights to an access seeker to require an access provider to alter fundamentally the nature and scope of the services it provides in its current business. As FOXTEL does not supply a digital subscription television service to non-FOXTEL subscribers, FOXTEL's Digital Set Top Units are not present in non-subscriber homes. FOXTEL only installs an STU when a subscriber connects to its service, and removes it once the subscriber disconnects. The STUs are a valuable resource and FOXTEL does not leave them unused in non-subscriber homes, as to do so would be inefficient and wasteful.

To require FOXTEL to supply Digital Set Top Unit Services to access seekers in non-subscriber homes would not be giving access to existing FOXTEL infrastructure or services. FOXTEL would be compelled to install an STU in these homes, provide for its maintenance and security, and supply ancillary services such as CA and SI services when it does not supply those services in relation to its own business in that home. The point can be illustrated by considering Telstra's HFC cable. The cable extends to finite locations. An access seeker is not entitled under Part XIC to require Telstra to extend the reach of the cable to locations that are not currently serviced by the cable. No such right exists in the standard access obligations under s152AR, the provisions of which proceed upon the assumption that the service to which access is given exists and is capable of being supplied by the access provider immediately to itself or to access seekers (see in particular s152AR(2), (3) and (8)).

The same analysis must apply in connection with FOXTEL's STUs. The 'facilities' that are used to provide FOXTEL Digital Set Top Unit Services comprise the cables from a subscriber's wall plate, the STU, the remote control and the cable to the television which are installed in a customer's premises. FOXTEL only supplies its Digital Set Top Unit Services to persons who subscribe to its digital subscription television services. Accordingly, under Part XIC an access seeker is entitled to receive Digital Set Top Unit Services (assuming declaration) in the locations in which those services are supplied. An access seeker has no right to insist on receiving Digital Set Top Unit Services in any other location.

This conclusion is consistent with the decision of the Full Federal Court in *FOXTEL Management v. Seven Cable Television* (2000) 102 FCR 555. In that decision, the Full Federal Court observed that FOXTEL's business comprises the transmission of programs and conditional access data which are received by the STU owned by FOXTEL (pages 557-558). The Court concluded that FOXTEL was a carriage service provider within the meaning of Part XIC because of the contractual obligations of FOXTEL to its customers, which included not only the provision of television content, but also the physical delivery of that content (page 575). The Court concluded that FOXTEL's service should be defined having regard to the commercial arrangements by which the service was actually provided to the customer (pages 575 -576).

The commercial arrangements between FOXTEL and its customers were central to the Full Federal Court's analysis. The Court concluded that FOXTEL was a carriage service provider only because of its actual contractual obligation to supply the service to its own customers. The Court

did not conclude, and could not have concluded, that FOXTEL supplied a carriage service to persons other than its customers, because FOXTEL was a carriage service provider only in respect of its own customers. As FOXTEL only supplies the declared service to its own subscribers, FOXTEL would have no obligation to provide Digital Set Top Unit Services under s152AR(8) to access seekers other than in relation to those subscribers.

(b) Supply of unbundled CA/SI services to non-FOXTEL homes

If FOXTEL cannot be compelled to supply STUs in non-FOXTEL homes, FOXTEL submits that it cannot be forced to supply CA and SI services to non-FOXTEL homes.

CA and SI services on their own could not be declared under Part XIC as they are not listed carriage services nor services that facilitate the supply of listed carriage services. CA and SI services are not necessary to supply carriage services. They are only necessary to enable decryption and viewing of an encrypted digital content service. Even if CA and/or SI services were "eligible services" under s152AL, it is very unlikely they would be declared as they are services which are able to be licensed from third parties.

The supply of CA and SI services are only caught under s152AR(8) as services which are 'necessary' for the supply of content services using the particular STUs used by the access provider. If the access seeker is not using the FOXTEL STUs then the access seeker has no right to be provided with these ancillary services by FOXTEL.

6.5 Competition implications of the 'tie'

In its decision, the Tribunal formed the view that the 'tie' of the supply of STUs to the supply of FOXTEL's basic package would be a significant deterrent to new entry, and that FOXTEL might be able to frustrate competition in the premium tiers by shifting programs from its premium to basic tiers.⁸⁴ These views formed by the Tribunal are based on at least the following assumptions:

- (a) it is technically and commercially feasible for FOXTEL to separate the supply of STU's and CA/SI services from the supply of its subscription television service;
- (b) if the Digital Set Top Unit Service were declared, FOXTEL could be legally compelled to supply any or all of the STUs or the CA/SI services to non-FOXTEL homes, and it would be reasonable to compel FOXTEL to do so;
- (c) FOXTEL has significant market power in respect of the supply of subscription television services;
- (d) FOXTEL is able to change the pricing and/or content of its premium and basic packaging at will without impacting its revenue; and
- (e) there is a likelihood of new entry by a person who wishes to supply a 'basic' subscription television services in competition with FOXTEL, rather than new entry by niche suppliers.

FOXTEL respectfully submits that each of the above assumptions, on which the Tribunal's views were based, is incorrect. The assumptions in paragraphs (a) and (b) above are discussed in Sections 6.2 to 6.4. The assumptions in paragraphs (c) to (e) are discussed below.

(a) FOXTEL does not have market power

FOXTEL submits that there is clear and overwhelming evidence that it does not possess market power in the supply of digital subscription television services. In his report at Attachment 6, Dr

⁸⁴ Tribunal decision at [299] and [301]

Philip Williams examines the market(s) in which FOXTEL competes, and assesses the extent to which FOXTEL exhibits market power. Dr Williams concludes that FOXTEL competes against other subscription television operators, commercial and national television broadcasters and suppliers of DVDs and videos. Dr Williams concludes on the basis of the structure of this market and FOXTEL's behaviour and performance that FOXTEL does not possess market power, and is subject to vigorous competitive pressures. The competitiveness of the market in which FOXTEL competes is discussed at greater length in Section 8.

Nor can it be suggested that FOXTEL's decision only to supply STUs to homes that are FOXTEL customers evidences its market power or creates market power. Suggesting that FOXTEL is a 'monopoly' in the supply of STUs by tying the STUs to the purchase of basic subscription television content is akin to suggesting that Citylink has a monopoly over the supply of E-tags, or that the Melbourne Cricket Club has a monopoly over the supply of the swipe cards which are required by its members to enter the MCG. Just as none of those suppliers of services which require the use of specialised or dedicated equipment (of greater or lesser complexity) has a monopoly in connection with the supply of that equipment (which can only economically be used to supply their services), neither does FOXTEL have a monopoly over the supply of STUs. Anyone could supply STUs if they chose to do so.

As discussed above, FOXTEL subsidises the supply of STUs to its subscribers in order to encourage the take up of subscription television services in Australia. Without subsidisation, take up would be seriously inhibited by the high capital costs of the STUs, especially Digital Set Top Units. FOXTEL has incurred substantial unrecouped losses since the commencement of subscription television in Australia, with those losses amounting today to approximately \$1 billion.⁸⁵ In those circumstances, it is not surprising that FOXTEL's business model is designed to maximise the take up rate of subscription television services, through providing STUs to consumers on a subsidised basis. The cost of the STUs is incorporated into the price for content services (both basic and premium tier packages) and is also subsidised, in the sense that FOXTEL has not been able to set retail prices at a level that has enabled full cost recovery. This has led to FOXTEL's substantial operating losses to date.

(b) FOXTEL is not able to alter its basic tier 'at will'

FOXTEL differentiates its content products by positioning them within basic and premium tiers, and charging different prices for each tier. This is efficient and normal pricing, because the pricing of different programs reflects users' willingness to pay.

It would be commercially disadvantageous to FOXTEL to remove programs from premium tiers and offer them as part of its basic tier in response to competition from an access seeker. It can reasonably be assumed that, in response to competition, FOXTEL will lose the custom of some, but not all of its premium tier subscribers, and thereby lose some revenue. However, if FOXTEL were to move some of its programs from premium tiers to the basic tier in response, it would weaken its premium tier offering, thereby hastening further the loss of revenue from that tier. It is unlikely that FOXTEL could reverse this process in the future as it is difficult to remove from customers what they are used to receiving without additional payment.

Nor could FOXTEL recoup lost premium tier revenue by increasing its basic tier pricing. It does not follow that increasing the price of the basic tier will increase revenues; indeed the opposite assumption is more rational. With the experience of nearly 10 years retailing subscription

⁸⁵ ACCC Report – Analogue Pay TV Access Undertaking [Foptel] p 23.

television in Australia, it is reasonable to assume that FOXTEL's current basic tier pricing is profit maximising, (ie. that no higher price would lower FOXTEL's losses). Accordingly, increasing basic tier prices is likely to lead to decreased subscriber numbers, and lower overall revenues from that tier. Although it is possible that the willingness to pay for the basic tier may increase if the product is improved by moving programs from premium to basic, and that FOXTEL may therefore be able to increase the revenue earned from its basic tier in this manner, it cannot be assumed that the marginal increase in revenue (if any) would offset the loss in revenue from the premium tier. FOXTEL would also lose subscribers if it raised the price of its basic package, together with the contributions they make to revenues. In any event, the Tribunal accepted it was very unlikely that FOXTEL would change the price of its basic package.⁸⁶

Accordingly, any concern that FOXTEL could or would seek to abuse any market position vis-à-vis access seekers is unfounded. FOXTEL submits that if it did engage in any anti-competitive conduct, this could be adequately addressed under Parts IV and XIB of the Act.

(c) Likelihood of new entry

The Tribunal's view also assumes that there is a likelihood of new entry by a person who wishes to supply a full 'basic' subscription television services in competition with FOXTEL. FOXTEL submits that any examination of the conditions of the market in which it competes, and its financial performance since it began supplying subscription television services, indicates that this is highly unlikely.

The likelihood and form of new entry by a subscription television service provider is examined by Dr Williams in his report attached to this submission. He concludes that new entry, in the form of a person who wishes to supply a 'basic' subscription television services in competition with FOXTEL, is highly unlikely and that if new entry is to occur, it is only likely to be in the form of a niche supplier.

⁸⁶ ACCC Report – Analogue Pay TV Access Undertaking [Foptel] p 23.

7. Price

7.1 Methodology

The price for the Digital Set Top Unit Services will be calculated by reference to the costing methodology described and explained in two papers by the Network Economics Consulting Group (**NECG**) attached as Attachment 7.⁸⁷ These papers were prepared in the context of the digital exemption application and FOXTEL submits the methodology proposed in them continues to be relevant to the special access undertaking.⁸⁸

The methodology is based on a TSLRIC approach and is consistent with international practice. It involves determining cost pools with costs being categorised either as directly attributable to an access seeker or a cost to be shared across all users of the STUs (including FOXTEL, which will, for the foreseeable future, be the primary cost payer). Attributable costs are allocated directly to access seekers. Shared costs are allocated amongst all access seekers, including FOXTEL, in proportion to the benefit derived. Revenue is used as a key proxy for the benefit derived, with ratings being used as a secondary proxy.

The objective underlying FOXTEL's digital access undertaking and its cost recovery pricing methodology is to balance the need for certainty for the FOXTEL shareholders, with certainty for access seekers.

FOXTEL submits that this pricing methodology is in the LTIE. It encourages the economic use of, and investment in, infrastructure as it is based on efficient cost-recovery principles (with a further reduction in the installed cost base as described below). It also promotes competition in the market in which subscription television services are supplied as it is fair, transparent and the costs of access are shared equally amongst FOXTEL and each access seeker.

This methodology was accepted by the Commission and approved by the Tribunal in the decisions regarding FOXTEL's exemption application.

During the Tribunal hearing, Channel Seven argued that if FOXTEL imposes the 'tying' restriction, access seekers should only be required to pay Attributable Costs as defined in Schedule 3 of the DAA, and should not be required to contribute to any of the other fixed or overhead costs incurred by FOXTEL in supplying services to access seeker customers. FOXTEL submits that such a proposition is both commercially and economically flawed. It assumes that:

- FOXTEL is able to recover all of its costs through revenues derived from supplying its services to its own customers and revenues derived from access seekers;
- an access seeker who supplies additional channels through a FOXTEL STU will increase the overall value to the subscriber of the combined service supplied through the STU, and therefore FOXTEL should be entitled to charge more; and
- the additional value to the subscriber of the combined service supplied through the STU can be captured by FOXTEL through increasing its prices to its customers, subject only to

⁸⁷ Attachment 7: NECG: FOXTEL Explanatory Material in relation to STU Pricing. Part A: STU Access Pricing dated 4 June 2002. Part B: Access Pricing Model for Digital Cable and Satellite STU's: Description of cost based pricing methodology dated 30 August 2002.

⁸⁸ However, the indicative figures and estimates are not relevant. These are now dealt with specifically in the PricewaterhouseCoopers reports which are referred to below.

the constraint that the sum of FOXTEL's and access seekers' prices cannot exceed the value which the subscriber places on the combined service.

The problems in this reasoning are immediately apparent. First, it assumes that the access seeker's channels will add value to the service received by a subscriber. This may or may not be correct. Secondly, the requirement that FOXTEL fundamentally alter its pricing structure and strategies to accommodate an access seeker is unreasonable. The only obligation that Part XIC places upon an access provider is to provide access to the services. Nothing in Part XIC, nor in any other access regime, suggests that an access seeker (or the Commission) can require that the access provider fundamentally alter its pricing strategy and behaviour merely to accommodate the desires of the access seeker.

FOXTEL submits there is no basis for access charges to be set other than in accordance with TSLRIC methodology. This methodology is the standard access pricing methodology adopted by the Commission and the Tribunal. It is fair and ensures that access seekers contribute to the fixed costs of the business. Adopting a TSLRIC methodology will ensure that FOXTEL's pricing is not compromised, which may otherwise distort demand for subscription television services in Australia. TSLRIC pricing will also ensure that FOXTEL and access seekers are able to compete on an equal footing, with neither called upon to subsidise the other.

This was recognised by the Commission in which said that it had two major concerns with accepting Channel Seven's argument:

- the implications of using LRMC/DAC [marginal] pricing on investment incentives for infrastructure owners; and
- the potential for a negative impact on FOXTEL's retail pricing⁸⁹.

The Commission said that using marginal cost would be a significant departure from its usual practice and was likely to adversely impact on investment in infrastructure. The Commission also said it would be problematic to implement access pricing that may potentially require a significant change to retail pricing. It accepted that competition between FOXTEL and the access seeker was most likely to be on a tier. However, it remained of the view that a TSLRIC- based pricing approach was the most appropriate⁹⁰.

This was also accepted by the Tribunal in relation to the exemption application and FOXTEL similarly submits should be accepted in relation to the undertaking.

7.2 IBAC

FOXTEL has included in its digital cost base an amount of \$280m for cable (reduced from \$858m) and \$115m for satellite for the cost of acquiring the installed analogue customer base which is migrated to the digital platform (the **IBAC**). These are the same amounts included in the Digital Access Undertaking accepted by the ACCC in 2003.⁹¹

The Tribunal also accepted the inclusion of the IBAC in the cost base, so long as FOXTEL -specific marketing costs were excluded. However, the Tribunal indicated that it wanted more rigorous verification of the cost inputs.

⁸⁹ ACCC – Final Decision on Digital Pay TV Anticipatory Exemption Application [Foptel] December 2003, p 48.

⁹⁰ ACCC – Final Decision on Digital Pay TV Anticipatory Exemption Application [Foptel] December 2003, p 49-50.

⁹¹ ACCC – Final Decision on Digital Pay TV Anticipatory Exemption Application [Foptel] December 2003 p[*].

The IBAC costs do not include brand marketing costs but only sales and marketing acquisition costs and retention marketing costs. Non-branded marketing comprises 68% of total marketing costs. FOXTEL has undertaken to the Commission that after the first 12 months and then not less than every 3 years, FOXTEL will arrange for its rate card calculations to be audited by an independent auditor and will make a copy of the independent audit available to the Commission. This should provide confidence to the Commission and access seekers that FOXTEL is calculating its rate card in accordance with the pricing methodology.

In satisfaction of this undertaking and in response to the Tribunal, FOXTEL engaged PricewaterhouseCoopers (**PwC**) to perform Agreed Upon Procedures in relation to the components of the IBAC Input Costs schedules. The PwC Agreed Upon Procedures Report in relation to the Cable IBAC Costs Schedules is attached at Attachment 8 and the PwC Agreed Upon Procedures Report in relation to the Satellite IBAC Cost Schedules is attached at Attachment 9. PwC has undertaken an audit of the Satellite STU gross capital purchase costs from 1 July 1999 to 30 June 2004 which is attached at Attachment 10. In relation to the gross capital cable STU costs, an audit report prepared in January 2001 is attached at Attachment 11. The audit performed by PwC at that time included gross capital STU cable costs incurred up until June 2000 which is still relevant as there have been no significant purchases of cable STUs since that time. In undertaking the Agreed Upon Procedures, PwC referred to FOXTEL's audited accounts and reconciled this with the IBAC Cost Schedule. A full audit of the costs by looking at the underlying records would have caused unjustifiable expense and delay. However, FOXTEL submits that the Agreed Upon Procedures Report is sufficient on the basis that the information presented in the IBAC Cost Schedule has been agreed back to the underlying financial books and records which support the audited financial statements for each year.

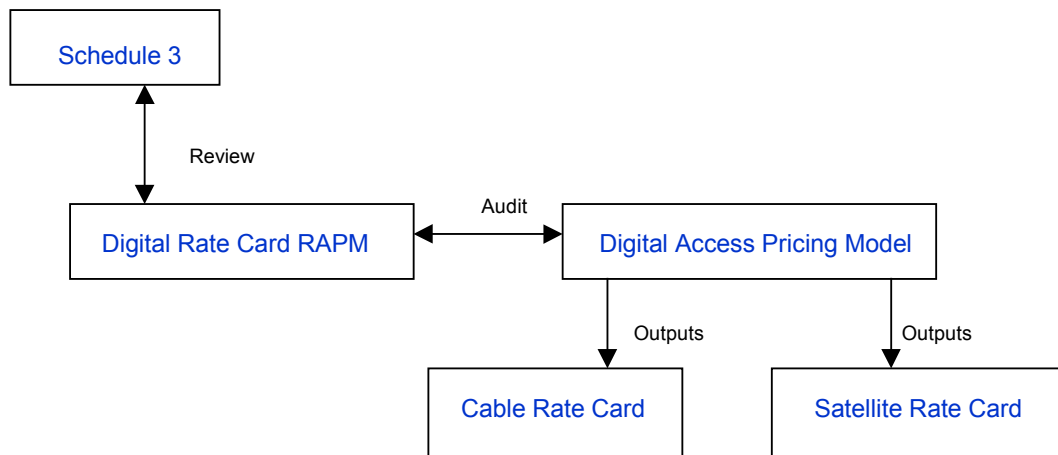
7.3 Digital Access Model

Schedule 3 of the Digital Access Agreement contains a pricing methodology, not a model for calculating the access price. It was therefore necessary to create a Digital Rate Card Regulatory Accounting Procedures Manual (**RAPM**) which specifies how the Digital Access Pricing Model was to be constructed.

FOXTEL asked PwC to review the RAPM under a review engagement (in accordance with Auditing Standards) and report to FOXTEL on any matters that indicated the RAPM had not been prepared, in all material respects, in accordance with Schedule 3. Their report is attached at Attachment 12.

FOXTEL then asked PwC to perform an audit on the Digital Access Pricing Model, in order to form an opinion as to whether the Digital Access Pricing Model is, in all material respects, prepared in accordance with the RAPM. The audit work included testing that the inputs to the digital model were correctly sourced as described in the RAPM. This report is attached at Attachment 13.

The following diagram illustrates the work that was undertaken by PwC in relation to the Digital Access Pricing Model.



7.4 Return on Capital

The return on capital is calculated as the cost of capital applied to the asset base, being the weighted average cost of capital (**WACC**) calculated using the Capital Asset Pricing Model (**CAPM**). As discussed in NECG's paper, during the early development stages of FOXTEL, the CAPM was not an appropriate approach to use and estimates of the cost of equity capital to venture capitalists were used instead. As the business develops, the CAPM is an appropriate approach to use, although it will be necessary to evaluate the limitations of the approach, and to supplement CAPM estimates.⁹² These limitations, and the appropriate means of correcting them, are discussed below.

Table 1 sets out the WACC parameters that FOXTEL proposes in relation to the CAPM.

Table 1: WACC parameters

Parameter	ACCC
Debt	20%
Equity	80%
Risk Free Rate	5.500
Market Risk Premium	6.0
Asset Beta	1.40
Debt Beta	0.33
Equity Beta	1.66
Debt Margin	2.50
Post Tax Cost of Equity (CAPM)	15.49
Effective Tax Rate	n/a

⁹² Additionally, it needs to be borne in mind that deferred costs from earlier periods will initially have been funded at the higher rates and then refinanced to the lower rates.

Nominal Cost of Debt	8.00
Franking Credit Utilisation-gamma	0
Pre-Tax Nominal WACC	n/a
Vanilla WACC	13.99

With the exception of the gamma, these are the same parameters accepted by the Commission in relation to FOXTEL's digital exemption and FOXTEL submits they remain appropriate. FOXTEL relies on the Commission's decision in this regard.⁹³

In relation to the value of franking credits, gamma, FOXTEL attaches a report by Professor Stephen Gray at Attachment 14. The report suggests that recent developments in the empirical estimation and conceptual understanding of gamma, as well as information about Australian corporate practice, means that 0.5 is no longer appropriate and the appropriate gamma is zero. While this does not change the WACC, which is a Vanilla WACC, it will impact on the "tax allowance" in FOXTEL's Digital Access Pricing Model, and result in a higher Maximum Allowable Revenue (post tax) and a higher access price.

FOXTEL also attaches a report by Professor Gray on the appropriate asset beta at Attachment 15. Professor Gray concludes that the appropriate asset beta for FOXTEL's service is 1.3 – 1.5. In relation to FOXTEL's digital exemption application, the Commission ultimately adopted an asset beta of 1.4, and FOXTEL accepted that asset beta for the purpose of the Tribunal decision. FOXTEL submits that the same asset beta should apply in relation to the special access undertaking.

7.5 Allocation – Revenue/Ratings

FOXTEL submits that the allocation based on revenue and ratings is a fair and appropriate method of allocating costs. It is the best measure of channel success and therefore of the value that users of Digital Set Top Units (both FOXTEL and access seekers) derive from that use.

This approach reduces the risk of distortion that may arise if allocation of cost recovery were to be assessed by reference to revenue alone or ratings alone. An approach that assessed revenues alone would favour those able to disguise the commercial benefits derived from providing the service, and may affect an access seeker's decision to provide the service, and the price it charged. Similarly, an approach that focused on ratings alone may burden access seekers whose content appealed to wide audiences, favour services that attract small audiences with highly inelastic demands, and affect how far an access seeker may be willing to go to seek additional viewers and consequently higher ratings.⁹⁴

The Commission and Tribunal accepted this allocation methodology in the context of the exemption application, and FOXTEL submits it should similarly be accepted here.

⁹³ ACCC – Final Decision on Digital Pay TV Anticipatory Exemption Application [Foptel] December 2003, p 58.

⁹⁴ NECG: FOXTEL Explanatory Material in relation to STU Pricing; Part A: STU Access Pricing dated 4 June 2002, p 15.

8. Undertaking Satisfies Criteria

8.1 Consistent with standard access obligations

As required by s152CBA(3)(a), FOXTEL's undertaking states that FOXTEL agrees to be bound by the SAOs referred to in s152AR, to the extent that those obligations would apply to FOXTEL in relation to the Digital Set Top Unit Service if the service were treated as an active declared service. As required by s152CBA(3)(b), FOXTEL's undertaking also states that FOXTEL undertakes to comply with the terms and conditions specified in the undertaking in relation to the obligations in s152AR.

FOXTEL submits the Commission can be satisfied that FOXTEL will supply all services contemplated by the SAOs to access seekers to the equivalent quality as it supplies those services to itself and sets out its reasons for this below.

In accordance with s152BA(6) and (7), FOXTEL's undertaking also sets out an expiry date for the undertaking which is 8 years from its commencement date. FOXTEL submits that 8 years is a reasonable time after which the need for, and appropriateness of, the undertaking should be reassessed in the light of current market conditions and technological developments. The 8 year duration of the undertaking responds to the Tribunal's concern about the length of the exemption (which was for 12 years) while giving FOXTEL the certainty it requires in respect of the terms and conditions of access. FOXTEL submits that as the service has not yet been declared, and it is not clear that it will be, it is appropriate that FOXTEL's volunteered undertaking be granted a longer time frame than that allowed for ordinary access undertakings (3 years). As well as giving FOXTEL certainty, it gives access seekers certainty as without the undertaking, access could be delayed by a declaration process and potential arbitration of access terms and conditions.

(a) Obligation to supply active declared service (s152AR(3)(a))

Section 152AR(3)(a) requires the access provider to supply the active declared service in order that access seekers can provide carriage services or content services.

Pursuant to the special access undertaking, FOXTEL will supply access to its Digital Subscriber Equipment, together with Digital Set Top Unit Services to enable access seekers to provide digital subscription television services and related services to their subscribers.⁹⁵ FOXTEL is only obliged to supply the Digital Set Top Unit Services to the access seeker referred to in clause 14.1(c) of DAA:

- (i) where the STU is in use by a FOXTEL subscriber;
- (ii) as a package and not in separate components;
- (iii) where cable STUs are used for cable, and satellite STUs are used for satellite;
- (iv) if the access seeker's broadcast signal complies with the Interface Specifications;
- (v) if the access seeker's channel information is provided; and
- (vi) if any Access Seeker Modem Content is compatible with the FOXTEL System.

FOXTEL submits that these conditions are consistent with the standard access obligations. FOXTEL has dealt with condition (i) in Section 6 above. In relation to condition (ii), FOXTEL

⁹⁵ DAA clause 4.1(a) and recital C.

submits that there is nothing in s152AR which requires FOXTEL to offer 'unbundled' services to access seekers. FOXTEL is obliged to supply the 'active declared service' under s152AR(3)(a), being the Digital Set Top Unit Service. This service is a composite, bundled service.

Conditions (iii)-(vi) are necessary to ensure the technical and operational reliability of the services it provides to access seekers. FOXTEL agrees that the Interface Specifications will be the same as the specifications it requires itself.⁹⁶ Further, conditions (v) and (vi) are required to enable the provision of EPG and modem services.

Access seekers will need to obtain all additional services they may require to provide digital subscription television services and related services to their subscribers, including (where necessary) the following services that are specifically excluded from the DAA:⁹⁷

- carriage services up to the Network Termination Point;⁹⁸
- interconnection or interfacing with any points other than FOXTEL's interface points;
- call centre services;
- subscriber management and related services (including billing);⁹⁹
- Digital Set Top Unit functionality (other than for decryption of the access seeker's subscription television services and related services, and the provision of modem services) including return path and interactive functionality;
- access to or use of Flash Memory, but only to the extent that Flash Memory is used or intended to be used for operational purposes;
- marketing;
- magazine or program guide listings (other than on the EPG);
- content creation; and
- playout services.

FOXTEL submits that the exclusion of these services is not inconsistent with the SAOs. FOXTEL deals with each of these in turn below.

(i) Carriage services

The Digital Set Top Unit Service the subject of the undertaking does not include the carriage of signals. FOXTEL submits that if that carriage service were declared, FOXTEL would not have an obligation to supply the service. FOXTEL is not a primary supplier of carriage services. Rather, it obtains those services from Telstra (in the case of cable) and Optus (in the case of satellite).

The effect of the decision of the Full Federal Court in *FOXTEL Management v Seven Cable Television* (2000) 102 FCR 555 is that FOXTEL is a carriage service provider only in relation to its own subscription television services for the purposes of Part XIC. Under s152AR(4), FOXTEL is not required to supply such services if the supply would prevent

⁹⁶ DAA clause 4.1(d).

⁹⁷ DAA recital E.

⁹⁸ Network Termination Point is defined in Schedule 10 to the DAA as "the wall plate or satellite dish....in a Subscriber Premises...".

⁹⁹ DAA clause 4.2.

FOXTEL from obtaining sufficient capacity to meet its own actual and reasonably anticipated requirements.

In the ACCC Report – Analogue Pay TV Access Undertaking, the Commission accepted that FOXTEL had no spare capacity and that any spare capacity it acquired was solely for its own use in order to satisfy its contractual obligation to subscribers. Any capacity not utilised by FOXTEL is with Telstra Multimedia. The Commission said:

the obligation to provide access set out in s152AR(3)(a) only extends to that part of the declared service which FOXTEL is capable of supplying through some right of control or ownership that it has over the relevant part of the service.¹⁰⁰

In relation to the digital service, FOXTEL is currently using all its contracted capacity. Telstra has set aside capacity specifically for the use of access seekers (at least 15% during the analogue/digital simulcast period and 30% once the simulcast period is over).

As FOXTEL does not own the infrastructure used to deliver the carriage services, whether or not FOXTEL has a right of control will depend on whether FOXTEL has acquired spare, unused carriage service capacity, and by virtue of that fact, could deprive an access seeker from use of that capacity. The Commission indicated it would be an absurd outcome for FOXTEL to be required to supply access even if it did acquire excess capacity, given that Telstra Multimedia has provided an undertaking to supply carriage services, and said that it did not consider such a requirement to be imposed by the legislation.¹⁰¹

It follows that FOXTEL would not have an obligation under s152AR(3)(a) to supply a service for the carriage of signals if it were declared and that FOXTEL does not need to include the supply of such carriage services in its undertaking.

(ii) Interface Points

FOXTEL submits that, in order to provide the Digital Set Top Unit Services, it is not necessary for FOXTEL's system to interconnect or interface with points other than the defined 'Interface Points'. FOXTEL is not supplying carriage services to access seekers (see (i) above), it is only providing the Digital Set Top Unit Services. Therefore it is necessary for the access seeker to acquire carriage services between various different 'Interface Points' on this FOXTEL System. Due to the technical requirements of the services being provided, these 'Interface Points' need to be determined by FOXTEL and be subject to access specifications (which are the same as FOXTEL requires of itself).

(iii) Subscriber Management Services

FOXTEL submits that it would not have any obligation to supply access to subscriber management services if the Digital Set Top Unit Service were declared. Subscriber management services (management of subscriber details and billing) are not carriage services or services that facilitate the supply of carriage services. Nor are they services that are 'necessary' for the supply of carriage or content services using the STUs under s152AR(8).

The SMS does not relate to access to the carriage service but is a means by which, in conjunction with the customer call centre service, a content service provider manages its customers, including billing those customers. An access seeker can be responsible for its

¹⁰⁰ ACCC Report – Analogue Pay TV Access Undertaking [Foptel] p 14.

¹⁰¹ ACCC Report – Analogue Pay TV Access Undertaking [Foptel] p 12.

relationship with subscribers, and set up its own SMS to manage its customer's entitlements and undertake billing. The only subscriber information needed by the access seeker is the subscriber's smartcard number, and smartcard verification is to be undertaken by FOXTEL as part of the undertaking.

In addition, access to FOXTEL's SMS system is a technically and administratively difficult solution to apply. In this regard, FOXTEL refers to and relies on the following reports that were prepared in the context of the analogue access arbitrations:

- Mark Ettridge, Market Ridge Pty Ltd: Consultancy Report to the Australian Competition and Consumer Commission. Subscriber Management and Conditional Access Systems at Attachment 16¹⁰²; and
- Greg Woolstencroft, VPG Consulting: Response to Consultancy Report to the Australian Competition and Consumer Commission Regarding Subscriber Management and Conditional Access Systems at Attachment 17.

(iv) Call Centre

Similarly, call centre services fall outside the scope of s152AR(8) as they are not 'necessary' for the supply of a content or carriage service using conditional access customer equipment. The customer call centre enables a content service provider to manage its customers and does not relate to access to the declared service (a carriage service). The call centre acts as an interface with customers and fulfils a number of functions including taking enquiries about provision of the service, signing new customers, resolving complaints, outbound telemarketing, upgrading and downgrading customers and maintaining data in relation to customers. Call centre services are not required as part of the conditional-access customer equipment or any other aspect of the carriage service. Rather, they are customer relations services akin to those used by a wide range of service providers (such as banks, insurance companies, car rental companies and so on) as a means of managing their business and communicating with customers.

It would create a commercial absurdity for the Commission to require FOXTEL to make available its customer service centre and entertainment consultants (**ECs**) to sell access seekers' products. Customer call centre services allow competitors to distinguish their products. The customer call centre is the critical customer interface for a subscription television operator. It would be impossible for FOXTEL's ECs to perform their function properly for FOXTEL if they were also obliged to take calls from customers or potential customers of access seekers. This is particularly so when one considers that FOXTEL will provide (as a tier to its basic package) certain channels which may be in competition with channels to be provided by access seekers. For example, if a potential subscriber called an EC seeking information on the relative merits of FOXTEL channels compared to the access seeker's channels, the EC would not be able to perform his or her job properly for either FOXTEL or the access seeker.

The only way FOXTEL could provide access seekers with customer call centre services would be to employ dedicated access seeker ECs (at the access seeker's cost) in a dedicated access seeker call centre. Access seekers would need to train these ECs in relation to their products, and at their own expense. Physical separation of the ECs would also be necessary to preserve confidentiality.

¹⁰² This report was referred to in ACCC Report – Analogue Pay TV Access Undertaking [Foxtel] p 9.

Given that the costs to the access seeker of FOXTEL providing call centre services described above are likely to equate to the costs of the access seeker establishing and maintaining its own customer call centre, it is clearly not necessary for the services to be provided. Therefore, the service cannot be a 'necessary service' pursuant to s152AR(8) and can clearly be provided by an access seeker.

This position has already been accepted by the Commission.¹⁰³

(v) Set top unit Functionality/Flash Memory

FOXTEL submits that the STUs are, and will remain, the property of FOXTEL (or its nominees) and that FOXTEL will also use these STUs to provide services to FOXTEL subscribers, as well as access seekers. Therefore, the access seeker is granted the right to access the STUs for specific purposes only. Further, this access is also limited to the extent necessary to receive the Digital Set Top Unit Services.

The provisions of clause 4.2(a)(v) do not prevent the access seeker from receiving the Digital Set Top Unit Services for the purposes of providing digital Subscription Television Services and related services to its subscribers.

Flash memory is electronic memory that forms part of a Digital Set Top Unit, the contents of which do not alter after the Digital Set Top Unit is de-powered. FOXTEL utilises the flash memory to store proprietary data for the proper functioning of the STU.

Excluding these services from the services FOXTEL will provide to access seekers is not inconsistent with the SAOs.

(vi) Marketing / Magazine / Content / Payout

FOXTEL is not required to provide these services under s152AR. Marketing, magazine and program guide listings are purely commercial activities that should be provided by access seekers. Content creation and payout involves the production and supply of content for delivery to the carrier (whether by cable or satellite) for transmission to subscriber homes.

In the event that the Digital Set Top Unit Service is declared, FOXTEL submits that its undertaking to supply Digital Set Top Unit Services is consistent with s152AR(3)(a).

(b) Technical and operational quality of the service (s152AR(3)(b))

FOXTEL currently supplies Digital Set Top Unit Services to itself. FOXTEL draws the Commission's attention to clause 4.1(b) of the DAA that provides:

FOXTEL is only obliged to supply Digital Set Top Unit Services to the access seeker to the equivalent quality as it provides Digital Set Top Unit Services to itself.

In the event the Digital Set Top Unit Service is declared, FOXTEL submits that the obligation set out in this clause covers the full active declared service to be supplied by FOXTEL and renders the undertaking consistent with the SAO requirements in s152AR(3)(b). This position was accepted by the Commission in relation to the analogue service.¹⁰⁴

Access seekers are also treated by FOXTEL in the same way it treats itself in relation to ordering and provisioning: s152AR(4A). The nature of the services is that they must be supplied

¹⁰³ ACCC Report – Analogue Pay TV Undertaking [Foptel] pp 14-15.

¹⁰⁴ ACCC Report – Analogue Pay TV Undertaking [Foptel], p 15.

simultaneously with the services FOXTEL provides to itself (and others). In relation to specific parts of the services where this is not the case, such as EPG services and channel numbering, FOXTEL will supply the services on a first come first serviced basis (see schedule 9 of the DAA).

However, due to the 'shared' nature of the services (FOXTEL is also providing the services to itself and other access seekers) and the fact that these are being provided over FOXTEL's system, access seekers must move with FOXTEL if FOXTEL wishes to upgrade or otherwise modify the services or system (see clause 11.2 of the DAA). If access seekers do not wish to accept these changes, then they may terminate the DAA on one months' notice (see clause 24.4 of the DAA). Access seekers may not require FOXTEL to change the services or system.

(c) Fault detection, handling and rectification (s152AR(3)(c))

FOXTEL is obliged to supply Digital Set Top Unit Services to access seekers to the equivalent quality in all respects as it provides those Digital Set Top Unit Services to itself. In FOXTEL's view, the definition of Digital Set Top Unit Services must also include appropriate fault management procedures. Therefore all issues regarding faults would be covered by the obligation in clause 4.1(b) of the DAA, as well as the procedural requirements of clause 8.

The fault procedures set out in clause 8 are designed to give some certainty to the access seeker about how faults will be processed. Faults reported by the access seeker will be treated in the same way as faults experienced by FOXTEL itself. Clause 8.3(c) specifically provides that FOXTEL will remedy any faults in accordance with its own fault rectification procedures from time to time which are in place in relation to faults uncovered by FOXTEL. Faults will be prioritised according to faults which have the highest service loss impact in terms of the number of subscribers affected (see Schedule 2, clause 5). As FOXTEL and access seekers will always share the FOXTEL Digital Set Top Unit pursuant to the agreement, any fault will impact on subscribers to both FOXTEL and access seekers.

FOXTEL therefore submits that the undertaking is consistent with this SAO.

(d) Obligation to permit interconnection of facilities owned or controlled by FOXTEL

FOXTEL submits that, in order to provide the Digital Set Top Unit Services, it is not necessary for FOXTEL's system to interconnect or interface with points other than the defined 'Interface Points'. FOXTEL is not supplying carriage services to access seekers (see 9.1(a)(i) above), it is only providing the Digital Set Top Unit Services. Therefore it is necessary for the access seeker to acquire carriage services between various different 'Interface Points' on the FOXTEL System. Due to the technical requirements of the services being provided, these 'Interface Points' need to be determined by FOXTEL and will be subject to access specifications (which are the same as FOXTEL requires of itself).

(e) Obligation to provide billing information

FOXTEL believes that the obligation in s152AR(6) and (7) to provide billing information is referring to the provision of information to the access seeker to enable the access seeker to bill its customers. This is apparent from the prescribed information relating to call services in the *Trade Practices Regulations* (Reg 28S). For services other than call services the billing information must be itemised as agreed.

FOXTEL submits that the SmartCard Authorisation Verification Information Services supplied by FOXTEL under Schedule 1 Part B satisfy this obligation. These enable access seekers to verify the services received by subscribers in order for them to bill subscribers appropriately.

If the obligation in s152AR(6) and (7) refers to billing of the access seeker itself, FOXTEL draws the Commission's attention to the detailed procedures covering billing and other payments in Clause 15 of the DAA. FOXTEL submits that Clause 15 is consistent with the SAOs in s152AR(6) and (7) of the Act.¹⁰⁵

(f) Conditional-access customer equipment

By supplying Digital Set Top Unit Services, FOXTEL is supplying all services which are "necessary to enable the service provider to supply carriage services and/or content services by means of the active declared service using the conditional-access customer equipment".¹⁰⁶

These services include access to STUs, Fly Cables, CA, SI and SmartCard Verification Information Services. These are the only services 'necessary' to enable the access seeker to use the FOXTEL STU. FOXTEL agrees with the Commission that 'necessary' services are confined to services that are dependent on the STU and integral to the provision of subscription television services. As discussed above, this does not include SMS or call centre services¹⁰⁷.

FOXTEL submits that the restriction of these services to FOXTEL subscriber homes is also consistent with s152AR(8) as discussed in Section 6 above.

8.2 Reasonableness

FOXTEL submits that when assessing the reasonableness of the undertaking, the Commission must look at the terms and conditions *as a whole*.¹⁰⁸ The Commission must weigh up the competing factors listed in s152AH and be satisfied that the terms and conditions as a whole are reasonable compared to the situation if the undertaking is not lodged.

FOXTEL submits that the terms and conditions of access to the Digital Set Top Unit Services set out in the DAA satisfy the test of reasonableness set out in s152AH(1), in particular as they will enable access seekers to gain access to the Digital Set Top Unit Services on the same basis and to an equivalent quality that FOXTEL itself gains access to the services.

(a) LTIE – with or without test

In considering the LTIE, the Commission must adopt a 'with and without' approach. To do so, it must look at the likely state of the market with the undertaking compared to that without the undertaking.

Without the undertaking, access seekers must rely on:

- FOXTEL's s87B undertaking to gain access, which expires in December 2007; or
- declaration of the service and the arbitration of terms and conditions of access.

FOXTEL submits that it is highly debatable whether the digital subscription television service would be declared even absent any undertaking by FOXTEL. Since the Commission declared the analogue subscription television broadcast carriage service in September 1999, there have been a number of changes in the market, including the advent of digital television by the open broadcasters, the increasing popularity of DVDs and the convergence of subscription television with other services. There is currently a range of choices for content distribution in Australia, with

¹⁰⁵ ACCC Report – Analogue Pay TV Undertaking [Foxtel], p 17.

¹⁰⁶ *Trade Practices Act* (1974) Cth s152AR(8).

¹⁰⁷ ACCC Report – Analogue Pay TV Undertaking [Foxtel], p 19.

¹⁰⁸ ACCC Report – Analogue Pay TV Undertaking [Foxtel], p 36.

these options likely to grow in the future. FOXTEL attaches a report in this regard from Mr John Paul of ACPG Pty Ltd at Attachment 16. Mr Paul examines current and future means of delivering audio/visual content, including cable, satellite, MMDS, mobile, broadband, IPTV, courier pidgeon. Based on current overseas deployment and developments in Australia, Mr Paul concludes that there are a number of ways of delivering audio/visual content and that these alternatives are either currently competitive or are likely to be so, to some extent, in the near future.

Consequently, FOXTEL submits that whether or not the infrastructure used to deliver Digital Set Top Unit Services is a bottleneck that would attract declaration is a real question.

In addition, Digital Set Top Unit Services are different to analogue services – there is greater capacity, the delivery technology is different and its applications are more varied. The Commission itself has acknowledged these differences and stated that because of them, it cannot be assumed that a Digital Set Top Unit Service would be declared.¹⁰⁹

Finally, the fact that FOXTEL has given a s87B undertaking also makes it unlikely that the service would be declared by the Commission, as the Commission would need to be satisfied that declaring the service would be in the LTIE *given that there was an access undertaking in place*. This means that the Commission would have to be satisfied that declaration promoted competition and the economically efficient use of and investment in infrastructure *more than* the existing access undertaking.

Declaration itself is an inherently uncertain process, both for access seekers and access providers and, like FOXTEL, many investors in future infrastructure may not be prepared to invest, or may alter their investment decisions given the risk of the service being declared and the uncertainty in the terms and conditions of access that declaration brings.

Even if the service were declared, arbitrations have proven to be lengthy and expensive and are unlikely to result in terms of access more favourable than those set out in FOXTEL's special access undertaking. With the undertaking, access seekers have greater certainty over the terms and conditions of access for 8 years (6 more years than the current 87B undertaking which is due to expire on 31 December 2007 unless FOXTEL extends its duration). The terms and conditions are also significantly improved from the current terms and conditions as they provide for:

- access to 'modem services' to supply Access Seeker Modem Content;
- access to the FOXTEL EPG;
- a longer term;
- termination on one month's notice at the access seeker's election; and
- increased satellite capacity, in that additional satellites that can be used by access seekers in conjunction with the undertaking.

FOXTEL discusses the reasonableness of the undertaking and the LTIE criteria in more detail below. If the Commission forms the view that FOXTEL's terms and conditions are reasonable then the undertaking should be accepted.

(b) Legitimate business interests of FOXTEL and its investment

The undertaking recognises FOXTEL's legitimate business interests. As discussed at 6 above, if the Commission were to require FOXTEL to supply STUs to non-FOXTEL subscribers, it would be

¹⁰⁹ Professor Allan Fels, Chairman, Australian Competition & Consumer Commission, ATUG Industry Seminar, "Telecommunications: Competition, effective regulation and investment", October 2001.

tantamount to forcing FOXTEL to become an infrastructure provider. This would place substantial pressure on FOXTEL's internal operations and FOXTEL submits this is not contemplated by Part XIC.

Although FOXTEL has a clear commitment to providing access seekers with Digital Set Top Unit Services, and access to FOXTEL's Digital Subscriber Equipment, FOXTEL submits that it is important to recognise that FOXTEL is not a utility company that provides essential or unique equipment, nor does it provide an essential service to consumers. Rather, it provides subscription television services, being one form of entertainment services with many potential substitutes.

Finally, FOXTEL submits that the other non price terms and conditions (discussed in some detail in 5 above) balance FOXTEL's legitimate business interests (looking at the criteria discussed at Appendix A (4)) with the interests of access seekers. Similarly, the access price methodology ensures that FOXTEL will recover the costs incurred in providing the service including a normal commercial return, but will not recover any lost profit from increased competition, consistent with the Commission's previous rulings.

(c) Interests of other users

The special access undertaking provides a path for access by other subscription television operators to the FOXTEL infrastructure. This will enable access seekers to compete with FOXTEL and others in the delivery of subscription television as well as, potentially, other services if the provider chooses to bundle its subscription television service with other services such as telephony-related services.

As FOXTEL must provide services to access seekers to the equivalent quality it supplies them to itself, it allows competition in the downstream market to be based on the cost and quality of the competing services, consistent with the Commission's guidelines.

FOXTEL submits that access seekers gain more certainty through this undertaking. As discussed above, declaration does not provide immediate access. Further, terms and conditions must be negotiated and, failing negotiation, arbitrated by the Commission which can be a lengthy process. In addition any determination made by the Commission is subject to the restrictions set out in s152CQ. In comparison, the undertaking sets out clearly the terms and conditions which the access seeker knows in advance. Once the access seeker has entered into an arrangement with FOXTEL it has a contractual relationship which it can directly enforce, and the circumstances in which that contract can be varied are extremely limited.

FOXTEL therefore submits that the undertaking gives at least as much certainty, and arguably more, to an access seeker than under a potentially long and complex declaration and arbitration process.

The special access undertaking is also consistent with the interest of the current user of FOXTEL's Digital Set Top Unit Services, ThoroughVision (**TVN**). TVN accesses the Digital Set Top Unit Services pursuant to the existing DAA and s87B undertaking. The special access undertaking will ensure that future access seeker's interests conform with those of TVN as it provides for conformity of terms and conditions of access (including price).

(d) Direct costs of providing access

The Commission has indicated that this means the access price should cover *at least* the incremental costs of access but not exceed the stand-alone costs.

FOXTEL's undertaking is consistent with this requirement as it allows for cost recovery by FOXTEL and a reasonable return on capital. This is more efficient and reasonable than recovery of the

incremental costs alone but does not exceed (or even approximate) the stand-alone costs as all costs are shared with FOXTEL on the basis of the value derived from the service (with FOXTEL the biggest user).

(e) Operational/technical requirements

As discussed at 6 above there would be serious operational and technical issues if FOXTEL were compelled to provide STU and/or CA and SI services to non-FOXTEL homes, which would impact on the reliability of the service.

To the extent that FOXTEL supplies access to FOXTEL homes, the access seeker is treated in the same way as FOXTEL. Consequently, there will be minimal operational or technical issues. Any operational or technical requirements are clearly set out in the undertaking. The terms and conditions deal with these requirements (eg. specifications, fault handling) in detail.

(f) Economically efficient operation of carriage service

This issue is dealt with below.

8.3 LTIE

(a) Promotion of competition

The first step in determining whether the undertaking will promote competition to assess the state of competition in the relevant market. This involves an identification of the relevant market.

The Commission has previously found that retail subscription television (regardless of delivery platform) constitutes a market separate from other entertainment and news services such as free-to-air television (**open broadcast**), home video rentals, cinema, radio and newspapers and magazines.¹¹⁰ However, the Commission has recognised that in evolving and dynamic markets, the market definition may change over time.¹¹¹ The Commission has also recognised that open broadcast and home video rentals may be considered the closest potential substitutes for subscription television.¹¹²

Dr Philip Williams identifies the markets which, in his expert opinion, are relevant to assessing whether the undertaking is likely to promote competition (see Attachment 6). Dr Williams concludes that:

- (i) the carriage service by which subscription television signals are carried by cable and satellite constitutes a separate market to the supply of the subscription television services;
- (ii) FOXTEL's business activities comprise the production, marketing and distribution of the FOXTEL service;
- (iii) the Digital Set Top Unit Services by which FOXTEL facilitates the carriage of its subscription television services to subscribers form part of the same market in which FOXTEL supplies the latter service, as the competitive constraints on the former are the same as the latter;
- (iv) FOXTEL's business is competitively constrained by the businesses of other pay television broadcasters, and most significantly by the businesses of the free to air broadcasters.

¹¹⁰ ACCC – Declaration of an Analogue Subscription Television Broadcast Carriage Service, p 24.

¹¹¹ Australian Competition and Consumer Commission, Media release entitled 'FOXTEL / Optus proposal 'likely to breach Trade Practices Act': Australian Competition and Consumer Commission dated 21 June 2002 at 2.

¹¹² ACCC – Declaration of an Analogue Subscription Television Broadcast Carriage Service, p 24.

Accordingly, Dr Williams concludes that FOXTEL competes in a market which includes subscription television operators, free-to-air broadcasters and, to a lesser extent, DVDs and videos. The assumptions upon which Dr Williams bases his conclusions are attached to his report. These assumptions are derived from statements made by FOXTEL in the C7 litigation, which are attached at Attachment 19. FOXTEL also relies on these statements to support its submission that the relevant market is a television entertainment market.

Dr Williams examines both the structure of the market and FOXTEL's behaviour and performance to assess whether FOXTEL has market power. He concludes that:

- (i) the available measures of market share demonstrate that FOXTEL's share of the television viewing audience is less than 14%;
- (ii) there are substantial barriers to entry to the Australian television broadcasting market by reason of regulatory restrictions and economies of scale coupled with sunk costs;
- (iii) FOXTEL faces strong competition from free to air broadcasters in all aspects of its business;
- (iv) FOXTEL has not been able to earn monopoly profits from its business to date, and there is no evidence that it will be able to do so in the future.

Having regard to the above factors, Dr Williams concludes that although full scale new entry to the television broadcasting market is unlikely, free to air broadcasters impose a strong competitive constraint on FOXTEL. The effect of this competition is that subscription broadcasters such as FOXTEL have struggled to become viable.

Dr Williams concludes, therefore, that the SAU is unlikely to encourage new entry by a full scale subscription television broadcaster. The SAU cannot overcome the existing barriers to entry: regulatory restrictions and economies of scale coupled with sunk costs. However, Dr Williams believes that the SAU may facilitate entry by a specialist niche broadcaster, by enabling the niche broadcaster to benefit from FOXTEL's existing infrastructure.

Having regard to market conditions and the competition between free to air and pay television operators, it is very unlikely that Australia will see new entry by a pay television supplier seeking to compete with FOXTEL's basic package. If new entry is to occur, it is likely to be in the form of a niche broadcaster. Accordingly, in assessing whether the SAU promotes competition, it is commercially unrealistic to consider whether the SAU is likely to lead to entry by a supplier of a full basic package; the commercially relevant question is whether the SAU is likely to reduce barriers to entry by a niche supplier.

In any case, FOXTEL submits that regardless of whether the market is defined as a broad market for television entertainment or a narrow market for subscription television, the undertaking is likely to promote competition by removing barriers to entry. This is because:

- the services provided to access seekers under the undertaking are the relevant services necessary to commence a subscription television service;
- the terms and conditions (including price and non-price) are reasonable and reduce barriers to access (particularly given the inclusion of modem and EPG services);
- the undertaking will facilitate increased quality of services for consumers, and expand consumer choice by providing for access by new service providers (principally niche players) on reasonable terms and conditions; and

- there will be benefits to consumers in general as a result, including by way of generating employment.

Having regard to these factors, the acceptance of the undertaking will serve only to enhance the competitiveness of the market (no matter how narrowly defined) by giving subscribers greater choice of service and enhancing the ability of access seekers to compete with FOXTEL and other retail subscription television operators.

(b) Economically efficient use of/investment in service

The special access undertaking sets out all the terms and conditions of access, including the pricing methodology.

The objective underlying FOXTEL's special access undertaking is to balance several competing needs. These include the need for certainty for the FOXTEL shareholders and certainty for those who are seeking access to its services. This is with a view to promoting competition in the provision of the subscription television services, as well as encouraging the economically efficient use of and investment in the infrastructure by which the services are delivered.

Technically feasible

FOXTEL submits that it is technically feasible for the services to be supplied and charged for pursuant to FOXTEL's undertaking having regard to the factors set out in s152AB(6), that is:

- the technology that is in use or is available;
- whether the costs involved are reasonable;
- the effect that supplying and charging for the services will have on the operation or performance of telecommunications networks;
- the legitimate commercial interests of the supplier; and
- the incentives for investment in the infrastructure by which the services are supplied.

As discussed above, however, it is not technically feasible for FOXTEL to provide access to its services in relation to non-FOXTEL homes as this will significantly impact on the reliability of the service.

In addition, if FOXTEL was compelled to supply access other than on a cost recovery basis, FOXTEL submits this would not be reasonable.

Legitimate commercial interests

This element has already been discussed above.

Incentives for investment

The report of the inquiry into the telecommunications regulatory regime initiated on 14 March 2005,¹¹³ by the Senate Environment, Communications, Information Technology and the Arts Committee discusses the importance of investment in telecommunications infrastructure. The Committee notes its concern that 'the level of capital investment in network infrastructure and the quality of the network are in decline',¹¹⁴ and recommends that the object of encouraging use of, and investment in, telecommunications infrastructure be given primacy in the operation of Part XIC.¹¹⁵

¹¹³ The Performance of the Australian Telecommunications Regulatory Regime.

¹¹⁴ The Performance of the Australian Telecommunications Regulatory Regime, p 35.

¹¹⁵ The Performance of the Australian Telecommunications Regulatory Regime, Recommendation 7.

This accords with the view of the Productivity Commission which suggested that such a goal should be elevated to the object of Part XIC.¹¹⁶

As discussed above, telecommunications infrastructure competition is essential and can only occur if investment is encouraged. FOXTEL is the only network provider to have invested in the provision of a network of this nature. It follows that other potential investors will monitor closely the terms and conditions of access to FOXTEL's infrastructure prior to deciding whether to make a similar outlay. The terms on which access is granted and the price which is received by FOXTEL will presumably impact a potential investor's decision whether to make investments in infrastructure of a similar magnitude. FOXTEL submits that accepting the undertaking on these terms will encourage the economically efficient use of and investment in the infrastructure used to provide the service.

Although FOXTEL has already invested in the infrastructure needed to provide the relevant service, it still requires certainty about the terms and conditions of access to that service, to enable it to assess further investment and the impact on its own internal operations.

FOXTEL submits that the terms and conditions of access contained in its undertaking promote economic efficiency: productive, allocative and dynamic.

FOXTEL submits that by balancing the interests of FOXTEL and access seekers, and by using a cost base pricing methodology, the undertaking will encourage use of the Digital Set Top Unit Services. This will promote competition without damaging incentives for future investment in technology and potential infrastructure competition.

¹¹⁶ Productivity Commission, 'Telecommunication Competition Regulation, Inquiry Report', Recommendation 9.1.

Appendix A

1. The long-term interests of end-users

In its decision on FOXTEL's exemption application,¹¹⁷ the Tribunal considered the meaning of the phrase 'long-term interests of end-users', and reached the following conclusions about each element of the phrase:

- 'long term' contemplates "sufficient time for all players to adjust to the outcome, make investment decisions and implement growth – as well as entry and/or exit- strategies";¹¹⁸
- 'interests' refers to attaining lower prices, better service and greater choice of products; and
- 'end users' include "actual and potential subscribers to subscription television services", other viewers in subscriber households and businesses such as hotels.

In determining whether the undertaking promotes the LTIE, regard must be had to the extent to which it is likely to achieve the following objectives:

- promoting competition in markets for carriage services and services supplied by means of carriage services (**listed services**);
- achieving any-to-any connectivity in relation to carriage services that involve communication between end users; and
- encouraging the economically efficient use of, and the economically efficient investment in, the infrastructure by which listed services are supplied.¹¹⁹

This list is exhaustive and the Commission may not have regard to other matters.¹²⁰

The Commission has taken the view that the LTIE within the context of Part XIC refers to the end-user's economic interests, such as lower prices, increased quality and greater diversity of goods and services¹²¹.

Coupled with the LTIE is the overriding concept that Part XIC exists to create 'greater competition' and 'an environment where there are incentives for investment and innovation'.¹²² Whether the undertaking will promote the LTIE depends on whether it will contribute to establishing an environment that will increase the likelihood of this occurring. To assess this, the Commission will consider the effect of the undertaking on access seekers in terms of rivalrous behaviour and investment decisions. In the context of declarations, the Commission has stated that this consideration should enable it to assess the resulting "economic benefits likely to flow to end-users in terms of price, quality and diversity of services".¹²³

In the report handed down by the Senate Environment, Communications, Information Technology and the Arts Committee on 10 August 2005 into the state of telecommunications infrastructure

¹¹⁷ Tribunal Decision at [120].

¹¹⁸ Tribunal Decision at [120].

¹¹⁹ s152AB(2).

¹²⁰ s152AB(3).

¹²¹ Australian Competition and Consumer Commission, Telecommunications services – Declarations provisions – a guide to the declaration provisions of Part XIC of the Trade Practices Act July 1999 (**Declarations Guide**), p 33.

¹²² Declarations Guide at p 33.

¹²³ Declarations Guide at p 34.

regulation, it was recommended that the goal of encouraging economically efficient investment in, and use of, infrastructure be given primacy in the competing considerations of Part XIC.¹²⁴ This recommendation reflects the view of the Committee that such investment is critical to the operation and development of the telecommunications industry in Australia.

2. Promotion of competition

This criteria is further expanded in sub-section 152AB(4), which says that regard must be had to the extent to which the thing will remove obstacles to end-users of listed services gaining access to listed services.

(a) Tribunal Comments

The Tribunal stated in *Sydney International Airport [2000] ACompT 1* (1 March 2000) that to find a service would 'promote' competition, does not require

that there would be an advance in competition in the sense that competition would be increased. Rather the notion of 'promoting' competition involves the idea of creating the conditions or environment for improving competition from what it would be otherwise.¹²⁵

It emphasised that, in formulating what the notion of 'promoting' competition entails, it had particular regard to the 'two stage process' of access regimes. It stated that the purpose of declaration is firstly to unlock a bottleneck in order to then promote competition in a market for the relevant service.¹²⁶ As the focus is on 'access', the regime is concerned with 'fostering' competition, which involves removing barriers to entry that may constrain competition in a downstream market.¹²⁷ The promotion of competition will be assessed by the Tribunal with respect to "furthering competition in a forward looking way" as opposed to "furthering a particular type or number of competitors".¹²⁸

The Tribunal concluded that whether something will 'promote competition' should be assessed by reference to the 'with or without test', specifically, whether the opportunities and environment for competition given declaration will be better than they would be without declaration.¹²⁹

(b) Assessing 'promotion of competition' – with or without test

The first step in determining whether an undertaking will be in the LTIE by promoting competition is to assess the existing state of competition in the relevant market(s). This requires identification of the relevant market(s) and an assessment of the state of competition in those market(s).

The second step is to assess the likely effect of the undertaking on competition in each relevant market. In doing so, the Commission should have regard to whether the special access undertaking will remove obstacles to end users gaining access to the relevant services: 152AB(4). The Explanatory Memorandum to Part XIC also states:

it is intended that particular regard be had to the extent to which the ...[undertaking]... would enable end-users to gain access to an increased range or choice of services.¹³⁰

¹²⁴ The Performance of the Australian Telecommunications Regulatory Regime, Recommendation 7.

¹²⁵ *Sydney International Airport* (2000) ACompT 1 (March 2000) (*Sydney International Airport*) at [106].

¹²⁶ *Sydney International Airport* at [107].

¹²⁷ *Sydney International Airport* at [107].

¹²⁸ *Sydney International Airport* at [108].

¹²⁹ *Sydney International Airport* at [106].

¹³⁰ Trade Practices (Telecommunications) Amendment Act 1997, Explanatory Memorandum p 41.

Therefore, in assessing whether the undertaking will promote competition, FOXTEL submits that the Commission should consider:

- whether the undertaking is likely to maximise opportunities for competitive entry, the likelihood of new entry and the number of parties that the market might support;¹³¹
- whether service providers can compete and win customers based on their relative merits (for example, their ability to provide services demanded by end-users of high quality and at low-cost);¹³²
- whether more efficient service providers can displace less efficient service providers;¹³³
- the extent to which the undertaking will provide consumers with increased quality of goods or services and/or lower prices;
- the extent to which real benefits to final consumers and the community in general are generated from the undertaking (including fostering business efficiency and expanding employment or preventing unemployment);¹³⁴
- whether the terms and conditions of access are reasonable, in particular whether prices reflect the efficient provision of the service (rather than the ability of the service provider to extract monopoly profits);¹³⁵
- whether the undertaking provides the services that users require;¹³⁶
- whether the undertaking eliminates or reduces non-price barriers to access;¹³⁷
- whether the service is likely to be declared (this does not require a declaration inquiry, however a determination of whether it is likely to declare the service under consideration is relevant);
- whether there is greater certainty given to access seekers by accepting an undertaking rather than leaving the issue to potential declaration after a further public inquiry; and
- whether competition is more likely to be promoted by accepting the undertaking than if the service were declared and terms and conditions arbitrated.

(c) Promotion of infrastructure competition

In assessing whether the undertaking will promote competition, FOXTEL also submits that the Commission should consider whether it will encourage competition at the infrastructure level.

In June 2000, the Government engaged the Productivity Commission (the **PC**) to produce a report on the state of competition regulation as it then applied to the telecommunications industry. The PC's Inquiry Report on Telecommunications Competition Regulation (Report No. 16 of 2001) (the

¹³¹ Sydney International Airport at [106]; *Final Determination for model price terms and conditions of the PSTN, ULLS and LCS services* October 2003 p 21.

¹³² *Assessment of Telstra's Undertakings for Domestic AMPS and GSM Originating and Terminating Access* August 1999 (**Assessment – Telstra's Undertakings [AMPS & GSM]**) p 23.

¹³³ *Assessment – Telstra's Undertakings [AMPS & GSM]* p 24.

¹³⁴ *Access Pricing Principles – Telecommunications "A Guide" (Telecommunications "A Guide")* p 7.

¹³⁵ Report – Assessment of Telstra's Undertaking [PSTN] pp 35-36.

¹³⁶ *Telecommunications "A Guide"* p 7.

¹³⁷ *Telecommunications "A Guide"* p 7.

PC Report) was released by the Government for public comment on 23 December 2001. In response to both the PC Report and its own considerations, the Government released some amendments to the Act designed to, amongst other things, 'facilitate investment in new telecommunications infrastructure'¹³⁸.

Facilitating such investment is an aim with which FOXTEL has always agreed, and which was stated as an integral part of the policy underlying the additions to the Act made by the *Telecommunications Competition Act 2002*¹³⁹. In the Explanatory Memorandum to the *Telecommunications Competition Act 2002*, it was stated that such a goal was an important "recognition of the importance of broadband and other telecommunications services to the future growth of the Australian economy".¹⁴⁰

FOXTEL submits that where technically and economically feasible, infrastructure competition should be the primary goal of telecommunications competition. Retail competition using the same network should only be considered where infrastructure competition is not possible. This is the point at which potential service providers should be able to use the existing infrastructure via an access regime. It is important to ensure that the provision of access to such providers is not given in place of them developing their own infrastructure. This will require an access regime geared towards favouring the further development of infrastructure. The importance of such an objective has been recognised by the Commission, with Mr Willett stating:

[T]he Commission is focused at present on promoting and protecting opportunities for the development of competitive infrastructure and services, including the deployment of new technologies on existing and refurbished networks. This is particularly pertinent, given the increasing momentum in investment in the industry after several years of very sluggish growth.¹⁴¹

FOXTEL submits that encouraging telecommunications providers to compete with one another at the infrastructure level will result in an economically efficient use of, and investment in, networks by providers who are attempting to better one another. These competitive effects would ultimately filter down to the retail level. This view is supported by the Senate Environment, Communications, Information Technology and the Arts Committee in its report into the performance of the Australian telecommunications regulatory regime. In its report, the Committee states:

Competition in the services market – and the attendant drive for innovation, lower prices and better customer service... can only be achieved in the longer term with continued efficient use of, and investment in, infrastructure.¹⁴²

3. Economically efficient use of/investment in infrastructure

The Act sets out the meaning of 'encouraging efficient use of infrastructure' in s152AB(6):

In determining the extent to which a particular thing is likely to result in the achievement of the objective referred to in paragraph (2)(e), regard must be had to the following matters:

- (a) whether it is technically feasible for the services to be supplied and charged for, having regard to:

¹³⁸ Explanatory Memorandum to the Telecommunications Competition Bill 2002.

¹³⁹ Explanatory Memorandum to the Telecommunications Competition Bill 2002.

¹⁴⁰ Explanatory Memorandum to the Telecommunications Competition Bill 2002.

¹⁴¹ Australian Competition and Consumer Commission Promoting Competition and Fair Trading; Australian Telecommunications Summit Sydney, Regulating Competition in the Telecommunications Market, Ed Willett, Commissioner 26 July 2004, pp 2-3.

¹⁴² The Performance of the Australian Telecommunications Regulatory Regime, p 83.

- (i) the technology that is in use or available; and
- (ii) whether the costs that would be involved in supplying, and charging for, the services are reasonable; and
- (iii) the effects, or likely effects, that supplying, and charging for, the services would have on the operation or performance of telecommunications networks;
- (b) the legitimate commercial interests of the supplier or suppliers of the services, including the ability of the supplier or suppliers to exploit economies of scale and scope;
- (c) the incentives for investment in the infrastructure by which the services are supplied.

The Commission's view is that the phrase 'economically efficient use of, and economically efficient investment in... infrastructure' refers to the concept of economic efficiency.¹⁴³ This concept consists of three components.¹⁴⁴

- **Productive efficiency.** This is achieved where individual firms produce the goods and services that they offer at least cost.
- **Allocative efficiency.** This is achieved where the prices of resources reflect their underlying costs so that resources are then allocated to their highest valued uses (i.e. those that provide the greatest benefit relative to costs).
- **Dynamic efficiency.** This reflects the need for industries to make timely changes to technology and products in response to changes in consumer tastes and productive opportunities.

The Commission may consider whether particular terms and conditions enable a carriage service, telecommunications network or facility to be operated in an efficient manner. This may involve, for example, examining whether they allow for the carrier or carriage service provider supplying the service to recover the efficient costs of operating and maintaining the infrastructure used to supply the declared service under consideration.¹⁴⁵

In the declarations context, the Commission's approach has been to analyse separately the impact of a declaration on:

- the economically efficient use of infrastructure used to supply carriage services and services provided by means of carriage services; and
- the economically efficient investment in infrastructure used to supply carriage services and services supplied by means of carriage services.¹⁴⁶

FOXTEL submits that the Commission should adopt the same approach when considering special access undertakings, although there is likely to be considerable overlap in the matters the Commission looks at under each criterion.

(a) Whether it is technically feasible for the services to be supplied and charged for

Section 152AB(6) requires the Commission to consider whether it is 'technically feasible' to supply and charge for the services and when assessing this, the Commission must have regard to:

¹⁴³ Report – Assessment of Telstra's Undertaking [PSTN] p 20.

¹⁴⁴ Declarations Guide at p 55.

¹⁴⁵ Report – Assessment of Telstra's Undertaking [PSTN] p 21.

¹⁴⁶ Declarations Guide at p 56.

- (i) The technology that is in use or is available

In the declarations context, the Commission has stated that it will look at the nature of the available technology and may examine experiences in other jurisdictions, taking account of differences in technology or network configuration, and seeking independent expert technical advice.¹⁴⁷

FOXTEL submits that the Commission should take the same approach when assessing special access undertakings.

- (ii) Whether the costs that would be involved in supplying and charging for the services are reasonable

In the declarations context, the Commission will take account of the direct costs of complying with the standard access obligations but not consequential or indirect costs that the access provider may incur, such as those resulting from increased competition in the markets in which it competes.¹⁴⁸ This is because the Commission believes that not all costs should be considered at the declaration stage. Rather, they are best left for consideration within the context of an undertaking or an arbitration. Reasonableness will then be evaluated from a commercial perspective and will depend on all the circumstances of each particular case.¹⁴⁹

FOXTEL submits that in the context of considering a special access undertaking, the Commission should identify all costs (ie direct and indirect) of supplying the service and then determine whether they are reasonable.

- (iii) The effects or likely effects that supplying or charging for the services would have on the operation or performance of telecommunications networks

In addition to costs involved in supplying and charging for the service, there may be spillover costs attributable to maintaining network integrity.¹⁵⁰ In the declarations context, the Commission has stated that it will consider the effects of third party access on the operation or performance of the telecommunications network and will expect the access provider to identify costs associated with these effects.¹⁵¹

FOXTEL submits that the Commission should adopt the same approach in relation to special access undertakings.

(b) The legitimate commercial interests of the supplier

In the declarations context, the Commission will examine whether the service can be provided while maintaining the legitimate commercial interests of the access provider.¹⁵² Where this is not possible, declaration is likely to have an adverse impact on incentives for economically efficient investment in infrastructure.¹⁵³

¹⁴⁷ Declarations Guide at p 58.

¹⁴⁸ Declarations Guide at p 59.

¹⁴⁹ Declarations Guide at p 60.

¹⁵⁰ Declarations Guide at p 60.

¹⁵¹ Declarations Guide at p 60.

¹⁵² Declarations Guide at p 62.

¹⁵³ Declarations Guide at p 62 – 63.

FOXTEL submits that the Commission should take a similar approach when determining whether to accept a special access undertaking. This will be considered further below in relation to the legitimate business interests of the supplier (see paragraph 4 below).

(c) The incentives for investment in the infrastructure by which the services are supplied

One component of economic efficiency is achieving an undistorted balance between the decision by potential providers to build their own infrastructure, and the decision to buy access to another provider's infrastructure. Indeed, the Senate Environment, Communications, Information Technology and the Arts Committee has recently described this as the 'policy intention behind the access regime'.¹⁵⁴

The importance of this balance has also been acknowledged by the Tribunal that stated:¹⁵⁵

Encouraging investment by access providers may be at the expense of investment by access seekers that would otherwise occur. Efficient investment, however, implies the right mix. That is, efficient outcomes mean that optimal buy/build decisions are being made, as assessed from the perspective of end-users. By 'optimal' is meant providing the best outcome in terms of prices, quality and diversity.

The Tribunal emphasised that in considering the LTIE, it needed to determine what would encourage 'efficient investment'.¹⁵⁶ This in turn involves arriving at an appropriate access price. As the Tribunal stated:

The right signals means prices that will allow sound investments to make a reasonable, but not excessive, return.¹⁵⁷

(i) Certainty to encourage investment in infrastructure

In order to encourage investment in infrastructure, it is critical that investors in new infrastructure have certainty about the terms and conditions of access, both price and non-price. The terms of access which a potential provider will be subject to will impact significantly the extent to which investors are prepared to invest in new infrastructure, if at all. Further, if they do decide to invest, the manner in which this is done will vary depending on the manner in which they will be required to provide others with access to their investment.

Access providers need to understand the basis upon which access will be granted to their service so that it can be factored into the decision whether or not to make (and continue to make) the investment. Additionally, potential investors need to have some form of assurance that they will not be disadvantaged by later regulation. Of particular concern is the price of access. Potential investors are likely to be deterred if the price of access to new infrastructure is not set at a level which allows full cost recovery over time. If it were not, the second-in-time would be greatly advantaged by the decision of the first-in-time to invest.

These possibilities create immediate concerns as any decision by access providers to invest in new infrastructure needs to be commercially defensible.

¹⁵⁴ The Performance of the Australian Telecommunications Regulatory Regime, p 82.

¹⁵⁵ Tribunal Decision at [130].

¹⁵⁶ Tribunal Decision at [129] and [130].

¹⁵⁷ Tribunal Decision at [132].

The Commission has also raised a concern in the declarations context that, while declaration will not impact the initial investment in the infrastructure, it may distort the access provider's decisions to maintain, improve and expand it. This may lead to inefficient investment that harms the LTIE.¹⁵⁸

FOXTEL submits that the Commission should also consider the impact that granting (or not granting) a special access undertaking will have on encouraging access providers to maintain, improve and expand the service or network. FOXTEL submits that the Commission should examine:

- whether the service in question would normally be declared;
- the nature of the certainty sought to be gained by the undertaking;
- the infrastructure that the undertaking relates to and the importance of such infrastructure and its benefits to end-users; and
- the nature and size of the investment required in the infrastructure.

4. Legitimate business interests of access provider

Another important criterion in assessing the reasonableness of the terms and conditions is set out in s152AH(1)(b) of the Act:

the legitimate business interests of the carrier or carriage service provider concerned, and the carrier's or provider's investment in facilities used to supply the... service concerned.

The Commission has defined the legitimate business interests of the access provider as:

its ability to at least recover the costs incurred by an efficient operator in providing [the services] including a normal commercial return on prudent investment commensurate with risk...However [it] do[es] not extend to achieving a higher than normal commercial return resulting from any lack of competition in the provision of [the service]¹⁵⁹

The Commission will consider a number of factors under this criterion, including:¹⁶⁰

- the provider's obligations to shareholders and other stakeholders, including the need to earn commercial returns;
- whether the undertaking provides appropriate incentives for the provider to maintain, improve and invest in the efficient provision of the service;
- the capital intensive nature of the service and the level of investment in specialised and dedicated assets or technology required in order to provide the service;
- the ongoing viability of the service and whether commercial returns are likely;
- the costs of 'extensions' or upgrades to the service incurred by the service provider (eg where capacity constraints may exist);
- existing contracts which comply with the Act, and which should not be affected;
- obligations imposed on service providers by Government and other legislation;

¹⁵⁸ Declarations Guide at p 63.

¹⁵⁹ Assessment – Telstra's Undertakings [AMPS & GSM] p 26.

¹⁶⁰ Access undertakings – A guide to Part IIIA of the Trade Practices Act (1999). Section 44X(1)(a), in Part IIIA of the Trade Practices Act is comparable to s 152AB(6)(b).

- the extent to which competition arising from access to a service generates real benefits to intermediate and final consumers and the community in general; and
- the ability of the supplier to exploit economies of scale and scope.

The Commission has stressed that 'legitimate business interests' should be interpreted in a manner consistent with the phrase 'legitimate commercial interests', which is also used in Part XIC. It found this to be the cost that would cover the provider's interest in earning a normal commercial return on its investment, but not compensation for loss of 'monopoly profits' occurring as a result of increased competition.

The price that will be considered reasonable by the Commission is therefore "a normal commercial profit"¹⁶¹ for the product under consideration.

5. Interests of persons who have rights to use the declared service

The interests contemplated by this criterion are access seekers' interests in competing with the access provider in respect of the cost and quality of its service in a downstream market. Therefore, the terms and conditions of access must not have the effect of artificially preserving the access provider's competitive position in a downstream market.¹⁶²

6. Direct costs of providing access

The concept of reasonableness also involves ensuring that, at a minimum, the access provider is reimbursed for the direct incremental costs of providing access to access seekers. However, the access price should not exceed the stand alone costs of providing the service.¹⁶³

7. Operational and technical requirements necessary for the safe and reliable operation of a carriage service, a telecommunications network or a facility

This criterion requires that the terms and conditions of access do not compromise the safe and reliable operation of the service. The Commission has linked this criteria directly to the price of access, stating:

An access price should not lead to arrangements between access providers and access seekers that will encourage the unsafe or unreliable operation of a carriage service, telecommunications network or facility.¹⁶⁴

The Commission has also recognised that access prices set at an artificially low level may lead to the degeneration of the underlying infrastructure.¹⁶⁵

8. Economically efficient operation of a carriage service, a telecommunications network or a facility

The Commission has stated that this criterion requires that:

an access price should encourage access providers to select the least-cost method of providing the service and provide those services most highly valued by access seekers.¹⁶⁶

¹⁶¹ Final Report – Assessment of Telstra's Undertaking [Line sharing] p 47.

¹⁶² Telecommunications "A Guide" p 9.

¹⁶³ Telecommunications "A Guide" p 10.

¹⁶⁴ Telecommunications "A Guide" p 10.

¹⁶⁵ Telecommunications "A Guide" p 8.

¹⁶⁶ Telecommunications "A Guide" pp 10-11.

It has also linked this criterion to the concepts of productive and allocative efficiency, which require, amongst other things, an access price to be set at a level that:

- allows for more efficient sources of supply to displace those that are less efficient;
- encourages the entry of lower-cost (or higher quality) firms; and
- minimises distortions in the use of infrastructure.¹⁶⁷

¹⁶⁷ Telecommunications "A Guide" p 8.