



**NOTIFICATIONS LODGED BY
TELSTRA CORPORATION LIMITED AND
TELSTRA PAY TV PTY LIMITED
IN RELATION TO
DIGITAL SUBSCRIPTION TELEVISION**

**SUBMISSION BY AAPT LIMITED
TO THE
AUSTRALIAN COMPETITION AND CONSUMER COMMISSION
IN RESPONSE TO THE NOTIFICATIONS**

FEBRUARY 2004



1. Introduction

AAPT Limited (**AAPT**) welcomes this opportunity to provide a submission to the Australian Competition and Consumer Commission (the **Commission**) in response to notifications N31277 and N31278 (together the **digital notification**) lodged by Telstra Pay TV Pty Limited and Telstra Corporation Limited (together **Telstra**) respectively.

AAPT submits that any public benefit of the third line forcing the subject of the digital notification (the **notified conduct**) will not outweigh the anti-competitive detriment caused by that conduct. The Commission should therefore exercise its powers under s93(3) of the *Trade Practices Act 1974* (Cth) (the **Act**) and 'reject' the notification.¹

2. Background

2.1 The analogue notification

On 15 July 2002 Telstra Corporation and Telstra Pay TV lodged notifications N31170 and N31171 respectively with the Commission in relation to the third line forcing of analogue subscription television (together the **analogue notification**). Legal immunity commenced on Monday 29 July 2002.

After conducting market inquiries, the Commission wrote to Telstra on 21 November 2002 and indicated that it did not intend to take any action in relation to the notified conduct at that stage.

2.2 AAPT's submission in relation to the analogue notification

In October 2002 AAPT made a submission to the Commission in relation to the analogue notification (the **analogue submission**).² AAPT does not repeat here the detailed arguments made in that submission. However, it wishes to refer the Commission to the analogue submission and submits that the concerns canvassed there are equally applicable to the digital notification.

AAPT does wish to reiterate briefly the following key points as they apply in the digital context.

(a) 'Technical' breach

In relation to both the analogue and digital notifications, Telstra has argued that the third line forcing conduct is only a 'technical' breach of s47 of the Act because Telstra Corporation and Telstra Pay TV are related bodies corporate.

¹ AAPT will use the language of the Commission 'accepting' or 'rejecting' the notification when referring to the Commission's exercise of its powers under s93 of the *Trade Practices Act 1974* (Cth).

² *Exclusive dealing notifications lodged by Telstra Corporation Limited and Telstra Pay TV Pty Limited: Submission by AAPT Limited to the Australian Competition & Consumer Commission in response to the notifications, October 2003.* This submission includes as Annexure B a paper by Stephen King, *The Potential for Vertical Price Squeeze: Pay TV Arrangements*.



However, if the notified conduct were engaged in by one company alone, then it would amount to full line forcing and be subject to a competition test. AAPT submits therefore that the conduct has the purpose of and results in a substantial lessening of competition in a number of telecommunications markets.

(b) Substantial lessening of competition

AAPT believes that Telstra's notified conduct will foreclose customers to AAPT and raise barriers to entry in a number of telecommunications markets thereby substantially lessening competition in those markets. These effects derive from Telstra's market power, particularly its vertical integration. More specifically, the anti-competitive effects are due to a combination of factors, namely:

- (i) the Telstra Rewards discounts;
- (ii) the terms on which many telecommunications companies acquire essential wholesale inputs from Telstra;
- (iii) one bill effects;
- (iv) customer inertia;
- (v) the economic complementarity of subscription television and broadband services; and
- (vi) the increased potential for Telstra to leverage its market power from those markets where it enjoys a substantial degree of market power such as fixed telephony and broadband into other more competitive telecommunications markets.³

3. The future with or without test

Telstra states that the notified conduct is very similar to the conduct the subject of the analogue notification that was accepted by the Commission.⁴

This might be thought to give rise to an implication that the Commission should accept the digital notification because this will only amount to an incremental change to the current situation. This argument suggests that in applying the 'future with and without test', the Commission should assume that the future 'with or without' Telstra's digital third line forcing is a future 'with' analogue third line forcing.

AAPT submits that the Commission should not assess the notified conduct on this basis. As Telstra notes, "it is expected that FOXTEL will cease to supply its existing subscription television

Deleted:

³ For more detail on AAPT's arguments in relation to bundling, see *Bundling in Telecommunications Markets: Submission by AAPT Limited in response to the ACCC draft information paper*, March 2003.

⁴ Letter from Sharon Henrick, Mallesons Stephen Jaques, on behalf of Telstra to Tim Grimwald, Australian Competition and Consumer Commission, dated 11 February 2004, p 1.



and related services within the next two years'.⁵ The Commission should take the cessation of the FOXTEL analogue service into account when considering the digital notification.

In applying the future with or without test, the correct counterfactual is therefore a future with the third line forcing of the digital FOXTEL service compared to a future without the third line forcing of any FOXTEL digital or analogue subscription television service. The Commission should therefore not consider the digital notification as only an incremental change to the current situation.⁶

4. Differing contexts of the analogue and digital notifications

At the time the Commission was conducting market inquiries in relation to the analogue notification, the Commission was also considering s87B undertakings offered by FOXTEL Management Pty Limited and FOXTEL Cable Pty Limited (together **FOXTEL**) and Optus Vision Pty Limited (**Optus**) in relation to content sharing (the **content supply agreement**).

The Commission undertook market inquiries in relation to the content supply agreement and the analogue undertaking concurrently, but as independent processes.

At the time of the Commission's consideration of the analogue notification, completion of the content supply agreement was contingent upon the Commission's acceptance of the analogue notification.⁷

In considering the analogue notification, the Commission was required to assess whether the notified conduct would result in any benefit to the public that would outweigh the detriment to the public, in accordance with s93 of the Act.

Any link between the analogue notification and the content supply agreement (which may have been relevant to the Commission's acceptance of the analogue notification) should play no role in the Commission's consideration of the digital notification. The content supply agreement has now been completed. The Commission's view on the digital notification will have no impact on that agreement.

There is also no link, as far as AAPT is aware, between FOXTEL's launch of a digital service and the approval of the digital notification.⁸

⁵ Letter from Sharon Henrick, Mallesons Stephen Jaques, on behalf of Telstra to Tim Grimwald, Australian Competition and Consumer Commission, dated 11 February 2004, p 8.

⁶ See discussion of the correct counterfactual in the context of the analogue notification in *Exclusive dealing notifications lodged by Telstra Corporation Limited and Telstra Pay TV Pty Limited: Submission by AAPT Limited to the Australian Competition & Consumer Commission in response to the notifications*, October 2003.

⁷ 'FOXTEL deal hinges on Telstra bundling' *The Australian Financial Review*, 9 September 2002, p 15, which reported comments of the Chairman of the Australian Competition and Consumer Commission.

⁸ FOXTEL's press release available at <http://www.foxtel.com.au/about/pressreleases.jsp> which states that FOXTEL will launch its digital service on 14 March 2004.



5. Ability of other telecommunications companies to compete with Telstra's subscription television offering

5.1 Telstra's submission

Telstra submits that one of the public benefits of the notified conduct is that:

the proposed conduct will increase competition in the telephony and other telecommunications services markets in which components of Telstra's Rewards Packages programme are supplied, by stimulating other telecommunications service providers to match or better Telstra Pay TV's and Telstra's offerings.⁹

Telstra further submits that one of the reasons that the notified conduct will not result in any detriment to the public is because:

the confidential re-supply agreements between Telstra and FOXTEL, and Telstra and AUSTAR are not exclusive. FOXTEL and AUSTAR are free to supply their subscription television services to other entities, including telecommunications companies for re-supply to retail customers in competition with AUSTAR, FOXTEL and Telstra Pay TV. In fact, TransACT and AAPT offer packages of FOXTEL's subscription television services in competition with Telstra Pay TV and Telstra. Further, Primus is also reported to be negotiating an agency or re-supply arrangement with FOXTEL. The proposed conduct, therefore, will not lessen the ability of competitors to compete on the merits of their services.¹⁰

5.2 Nature of the resupply arrangements

Telstra states that other telecommunications providers are able to acquire FOXTEL and resupply it in competition with Telstra in a bundle in a similar manner to Telstra. However, this submission overlooks the different nature of the re-supply arrangements available. As AAPT understands it, there are three types of arrangements that FOXTEL may enter into with telecommunications companies: reselling; content supply; and agency.

A true reseller of subscription television purchases the FOXTEL service and then resells it to customers. The reseller is able to set the price of the service and the customers remain customers of the reseller, not customers of FOXTEL.

The second type of arrangement is content supply. This is available to a telecommunications company with its own network for transmitting subscription television. Under this arrangement, a telecommunications company purchases content, such as a certain selection of channels, from FOXTEL, and uses its own network to deliver this service to its customers. As with the reselling scenario, the customers are not FOXTEL customers and the price is set by the telecommunications company, not by FOXTEL. An example of a telecommunications company which purchases content only is Neighbourhood Cable.

The third type of arrangement is that which has been offered to telecommunications companies such as AAPT who do not own their own network for the delivery of subscription television.

⁹ Telstra Pay TV Pty Limited's Form G Exclusive Dealing Notification N31277, p6 and Telstra Corporation Limited's Form G Exclusive Dealing Notification N31278, pp 7-8.

¹⁰ Telstra Pay TV Pty Limited's Form G Exclusive Dealing Notification N31277, p6 and Telstra Corporation Limited's Form G Exclusive Dealing Notification N31278, p 6-7.



Under such arrangements, the telecommunications company can sell subscription television, but it does so only as an agent, not as a reseller. The customer is therefore a FOXTEL customer. Most importantly, the agent has no ability to set prices, which are determined by FOXTEL.

It can be seen that for a telecommunications company without its own network for the transmission of subscription television, the reselling arrangement is preferable to the agency arrangement.

AAPT believes that Telstra has the first type of arrangement with FOXTEL and is a true reseller of FOXTEL. Although Telstra transmits the FOXTEL service over Telstra's HFC cable, AAPT does not believe it is correct to characterise Telstra as a purchaser of content in the way that one may characterise Neighbourhood Cable's arrangement with FOXTEL.

5.3 Public benefit

Telstra's resale arrangement allows it to provide the subscription television to customers as Telstra customers and Telstra has the ability to determine the retail price. By contrast, AAPT has been unable to negotiate a similar resale arrangement.¹¹

As a result, although AAPT can offer its customers access to subscription television, it lacks the ability to set prices and does not 'own' the customer. This puts AAPT at a distinct disadvantage to Telstra.

It is therefore misleading for Telstra to suggest that because its agreement with subscription television providers are non-exclusive, any other telecommunications company can negotiate similar arrangements. The practical reality is that AAPT has been unable to negotiate the *same* type of arrangement.

Therefore, if the digital notification is permitted, Telstra will have an arrangement with subscription television providers that cannot be replicated by any carrier without its own network. This means that no such carrier can compete with Telstra on the same terms.

6. Comments on issues raised by Telstra

6.1 Transparency

Telstra submits that:

the price of each component of any package including subscription television services will be transparent.¹²

The fact that the price of each component of Telstra's bundle is apparent on the customer's bill, does not meet the criticisms of Joshua Gans and Stephen King in their paper entitled 'Achieving

¹¹ For a discussion of AAPT's negotiations with FOXTEL, see *Exclusive dealing notifications lodged by Telstra Corporation Limited and Telstra Pay TV Pty Limited: Submission by AAPT Limited to the Australian Competition & Consumer Commission in response to the notifications*, October 2003, Annexure A.

¹² Telstra Pay TV Pty Limited's Form G Exclusive Dealing Notification N31277, p 7 and Telstra Corporation Limited's Form G Exclusive Dealing Notification N31278, p 6.



Price Transparency in Bundles' dated 21 October 2002.¹³ Those writers' views are well known and are not repeated here other than to note their brief conclusion in relation to Telstra's rewards program:

Telstra's bundling does not allow full price transparency to either competitors or regulatory authorities. From the perspective of competitors, they do not know the average price customers are actually paying for a Telstra service. In particular, competitors need to know what price the greatest proportion of Telstra mobile customers are paying to know what price to beat. However, without detailed information regarding Telstra's subscribers to fixed line, Pay TV and internet, it cannot easily assess this. In this respect, bundling makes pricing less transparent.¹⁴

6.2 Telstra's Forecasts

Telstra's submission in support of its notification contains a number of forecasts as to the effect of its proposed offerings of digital subscription television on subscriber numbers and the take-up rates of other services. The Commission will find it difficult to assess the accuracy of these forecasts as the Commission has failed on previous occasions to institute appropriate record-keeping rules to monitor the outcomes after decisions have been made.

6.3 Subscription television services as an economic complement

The Commission has asked Telstra whether a subscription television services is an economic complement to either telephony services or broadband services.

Telstra responded that subscription television services are not an economic complement of telephony services. However, its response in relation to the complementarity of subscription television services and broadband services is far less clear. In AAPT's view it is implicit in a number of submissions made by Telstra that these services are complements.¹⁵ Telstra has indicated that:

- Telstra's bundling of subscription television with telephony and other telecommunication services will increase the penetration of subscription television.¹⁶
- The increased penetration of subscription television will lead to, or at least contribute to, an increased penetration of broadband.¹⁷

¹³ Joshua Gans and Stephen King, 'Achieving price transparency in bundles', 21 October 2001, submitted to the Australian Competition and Consumer Commission.

¹⁴ Joshua Gans and Stephen King, 'Achieving price transparency in bundles', 21 October 2001, submitted to the Australian Competition and Consumer Commission, 5.

¹⁵ See for example letter from Sharon Henrick, Mallesons Stephen Jaques, on behalf of Telstra to Tim Grimwald, Australian Competition and Consumer Commission, dated 11 February 2004, p 5; and Telstra's submission to the Senate Environment, Communications, Information Technology and the Arts Committee in its Inquiry Into Competition in Broadband services dated 30 September 2003 and accompanying report by any NECG entitled *Quantifying Differences Between Broadband Penetration Rates for Australia and Other Countries*, July 2003.

¹⁶ Telstra has said that its notified conduct will 'assist the long-term viability of the subscription television services industry in Australia. To date, the subscription television services industry has been characterised by significant annual losses and relatively low, flat penetration rates'. Telstra Pay TV Pty Limited's Form G Exclusive Dealing Notification N31277, p 6 and Telstra Corporation Limited's Form G Exclusive Dealing Notification N31278, p 5.



It necessarily follows from the above that the two services are complements because a fall in the price for subscription television, will lead to an increased demand for broadband services. AAPT notes in this regard that Telstra's definition of economic complements is an oversimplification.¹⁸

It appears to AAPT that the Commission needs to look at the question of complementarities closely and require a much more substantive response by Telstra to its enquiry in relation to this issue. It is trite economics that the higher the complementarity of two services the greater the anti-competitive implications of bundling those services. This has been recognised by the Commission, which has stated that:

the relationships between the goods or services provided in the bundle, such as whether they are complementary or a combination of wholesale and retail products, ... can magnify any anti-competitive effect.¹⁹

6.4 Pricing

The Commission asked Telstra whether its notified conduct would be likely to result in a price squeeze for ADSL services. Telstra's response to this enquiry is brief. In AAPT's view this is an important issue and requires detailed consideration by the Commission.

AAPT understands that the Commission is currently investigating whether there are competition concerns in the broadband market by reason of Telstra's recent and significant price reductions for broadband services.²⁰ Telstra has commented that its proposed discounts 'could be easily matched by other suppliers'. This is not AAPT's expectation given the response by industry players to Telstra's announcement.²¹

6.5 Will FOXTEL and Optus be competitors following FOXTEL's proposed launch of Digital Subscription Television Services?

The Commission has asked Telstra whether FOXTEL and Optus will continue to be competitors following FOXTEL's proposed launch of digital subscription television services. Telstra has referred the Commission to FOXTEL to address this enquiry. AAPT would be grateful to receive a copy of FOXTEL's response so it may consider it. AAPT notes that Optus does not have any

¹⁷ NECG, *Quantifying differences between broadband penetration rates for Australia and other countries*, July 2003, at p 4.

¹⁸ Telstra's definition is 'Two services are economic complements if, as a consequence of a change in the price of one service, there is a change in the demand for the other service.' Letter from Sharon Henrick, Mallesons Stephen Jaques, on behalf of Telstra to Tim Grimwald, Australian Competition and Consumer Commission, dated 11 February 2004, p 5.

¹⁹ Australian Competition and Consumer Commission, *Bundling in Telecommunications Markets*, August 2003, at p 13.

²⁰ As reported in 'Broadband price battle explodes', *The Australian*, 23 February 2004 available at <http://australianit.news.com.au/articles/0,7204,8739520%5e16123%5e%5enbv%5e,00.html>.

²¹ See for example 'Telstra broadband move could spell the end of dial-up', *Communications Day*, 17 February 2004; and 'Broadband price battle explodes', *The Australian*, 23 February 2004 available at <http://australianit.news.com.au/articles/0,7204,8739520%5e16123%5e%5enbv%5e,00.html>.



current plan to offer digital subscription television services and notes therefore that FOXTEL will be the only provider of digital subscription television services in metropolitan areas.