



BAKER & MCKENZIE
THE GLOBAL LAW FIRM

Memorandum of advice

Australian Hotels Association (NSW) ("AHA") and SKY Channel Pty Limited

You have asked us to advise the AHA in relation to:

- (a) any potential legal claims that the AHA, or any of its members, may have against SKY Channel Pty Limited ("SKY") and/or TAB Limited ("TAB"); and
- (b) the general strategy to be adopted in dealing with SKY and in relation to these potential claims.

We provide you below with our preliminary views in relation to these matters.

In offering our views, we have had regard to the following:

- the brief provided to Mr Hilton, SC, prepared by JDK Legal;
- the report of Hank Spier dated 29 May 2002; and
- our discussions with John Miller.

In the course of this advice, we have suggested where further evidence or instructions will be required to offer a more concluded view.

Introduction and overview

1. A range of trade practices causes of action against SKY/TAB are potentially available to the AHA and/or certain of its members in relation to the provision of SKY racing services and/or PubTAB services to AHA members.
2. At this stage, we do not have all of the information we need to make a conclusive and definitive assessment of the prospects of success of each of these claims. Further, given the time constraints and the absence of certain information, we have not undertaken a full assessment of the degree of competition in the relevant market or markets which is necessary for some of the causes of action based on certain provisions of the *Trade Practices Act* discussed in this letter.
3. Nevertheless, on the basis of the documents and information provided to us, the cause of action with the most potential is for a breach of the unconscionability provisions contained in the *Trade Practices Act* (section 51AC).

4. The other actions that are potentially available to the AHA and/or certain of its members include: misuse of market power (section 46) and anti-competitive conduct in a telecommunications market (section 151AK read with section 151AJ). The potential section 46 issue is dealt with in significant detail below. An action for breach of section 151AJ is potentially available as SKY may be seen to have a substantial degree of market power in a relevant telecommunications market. There is, however, a question as to whether the effect of the anti-competitive conduct is felt in a telecommunications market as is required. Further and most importantly, proceedings can only be commenced under this part of the *Trade Practices Act* if the alleged conduct is of a kind dealt with in a Part A Competition Notice issued by the ACCC that was in force at the time when the conduct occurred. As far as we are aware, the ACCC has not issued (and is unlikely to issue) a Part A Competition Notice. In addition to these matters, experience dictates that these types of actions are again notoriously expensive and difficult to maintain. Accordingly, at this stage and without further information, our recommendation is that these actions not be pursued.
5. Finally, there is a possibility that an action based on a breach of section 45 of the *Trade Practices Act* exists as a result of the exclusive arrangements between SKY and each of the racing venue owners (eg the Australian Jockey Club). Section 45 prohibits any contract, arrangement or understanding which has the purpose or likely effect of substantially lessening competition. This issue may warrant further exploration.
6. Some of the causes of action referred to in this letter will be equally available to the AHA and each of its members while other causes of action are more personal in nature (eg, section 51AC) and therefore will only be available to particular AHA members which are individually able to establish that they meet the particular requirements of the cause of action.
7. Accordingly, in examining the prospects of an action for breach of section 51AC we will be need to explore the particular facts and circumstances of individual AHA members. At this stage, apart from the particular information which was included in the brief to Mr Hilton, SC, concerning the Harbord Beach Hotel and the Berry Hotel, we do not have any information or documents concerning the particular dealings between AHA members and SKY/TAB.
8. Of course, if a decision is made to further consider the possibility of an action based on breach of either section 51AC and/or section 46 with SKY and/or TAB then we should select the particular AHA member(s) which best satisfies the requirements of each of the relevant sections. That is, in general terms that particular AHA member (or group of members) that has been most harshly dealt with by SKY or is most obviously disadvantaged by the adoption of the fee formula based on beer literage sales and PubTAB commissions.
9. Having outlined a number of potential actions that may be available to some or all AHA members, it should be borne in mind that both SKY and TAB have undoubtably sought and received thorough legal advice concerning how each of those parties should structure their businesses and activities so as to avoid running

the risk of unlawful conduct or illegal contractual arrangements. This is particularly the case given the TAB was the beneficiary of a statutory monopoly in relation to off course totalizator services. As we do not, at this stage, have all the information and documents necessary to make a conclusive and definitive assessment of the prospects of success of each of these claims we should therefore factor this in when considering the potential causes of actions referred to above.

10. In terms of the general strategy to be employed in relation to the potential actions referred to in this letter, we recommend that the AHA and/or its members:
- (i) continue with their application for authorisation for the AHA to collectively negotiate on behalf of its members with various parties, including SKY and TAB;
 - (ii) that the potential actions referred to in this letter that have reasonable prospects be used as leverage with SKY and TAB in an attempt to bargain for more equitable arrangements in relation to the provision of SKY Racing services;
 - (iii) if appropriate, a cause of action with reasonable prospects be commenced against SKY and/or TAB to assist with (ii) above.

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Background

11. The AHA is an industry association seeking change for the benefit of the hotel industry in general and its members in particular. The AHA offers various services to its members including:
- engaging in negotiations with trade unions on various matters;
 - liaising with industry suppliers to bring the best possible deals to members;
 - researching and advising on a range of legal matters common to hoteliers; and
 - providing a forum for member hoteliers to meet and discuss ideas and problems.
12. Many of the AHA's members operate hotels with PubTAB and receive transmission feed from SKY in the form of live television and sound broadcasts of race meetings held throughout Australia.
13. SKY is effectively the sole provider of live racing television services *directly* to TAB agencies in various states and territories of Australia, hotels, racing venues and indirectly to individuals through various pay TV operators such as Foxtel, Optus Vision, Austar and smaller regional pay TV operators. On the basis of SKY's own publicly disseminated information, SKY has grown to be "Australia's

foremost satellite broadcaster". Further, SKY claims that its SKY Racing program "has been a major driver of new pay TV subscriptions" and that "there is no question that the Australia racing industry would not be as strong as it is today without the presence of SKY".

14. SKY transmits its service via the Optus B3 Satellite in digital format, and its transmission is now available at over 5000 outlets across the country reaching an estimated two million viewers each week.
15. We understand that SKY's subscription fee to access its service is based on differing formulae depending on the industry in which the recipient operates in. Based on material available on SKY's web-site, its fees vary from industry to industry because *"each venue's trading figures vary greatly"*. In the hotel industry, SKY's fees are based on beer literage sales and PubTAB commissions.
16. For the purpose of this advice, it important to note that both SKY and the radio station 2KY which broadcasts live racing are wholly owned subsidiaries of TAB.
17. Many of the AHA's members also act for agents of TAB in relation to PubTAB at which the public can place bets on race meetings throughout Australia. We are instructed that TAB only supplies its PubTAB services to those hotels which also take transmission services from SKY.
18. In addition to taking supply of transmission services from SKY, many of the AHA's membership also take supply of Pay TV services from Foxtel. It is also important to note that Foxtel is a re-distributor of the SKY Racing program to Foxtel subscribers. Notwithstanding this, the hotels are not permitted to take supply of Foxtel's SKY Racing program for broadcast or re-transmission in the hotels to the patrons. We understand that the SKY Racing program aired on Foxtel is identical to the program aired on SKY.
19. The AHA and many of its members, are aggrieved at the price at which SKY provides its services to them. In particular, the AHA and its members are concerned that SKY's fees are linked to the particular hotels beer literage sales and PubTAB commissions. Further, the AHA and its members are concerned with the way in which SKY deals with the hotels in particular SKY's "take it or leave it" attitude to contracts and its refusal to negotiate with the hotels.
20. Currently, the individual hoteliers negotiate on an individual basis with SKY for the provision of racing services. The AHA is progressing an application for authorisation pursuant to section 88 of the *Trade Practices Act* with the ACCC which, if granted, will allow the AHA to negotiate with third parties, including SKY and TAB on behalf of its members.

Possible causes of action

21. Based on the information that has been provided to us, there are a number of *possible* causes of action that the AHA and/or its members may have against SKY, TAB and/or Foxtel as a result of the conduct and matters described in this letter. In summary, the possible causes of action are:

- (a) breach of section 46 of the *Trade Practices Act* which prohibits the misuse of market power;
- (b) breach of section 151AK read with section 151AJ of the *Trade Practices Act* which prohibits anti-competitive conduct in a telecommunications market;
- (c) breach of section 47 of the *Trade Practices Act* which prohibits anti-competitive bundling or tying of goods;
- (d) breach of section 45 of the *Trade Practices Act* which prohibits agreements between competitors which substantially lessen competition in any market as well as price and market fixing arrangements; and
- (e) breach of section 51AC which prohibits a corporation engaging in unconscionable conduct.

22. We set out below in further detail our comments on each of the possible causes of action.

Breach of section 46 – Misuse of market power

23. Section 46(1) of the *Trade Practices Act* provides that:

"A corporation that has a substantial degree of power in a market shall not take advantage of that power for the purpose of:

- (a) *eliminating or substantially damaging a competitor of the Corporation or a body corporate that is related to that body corporate in that or any other market;*
- (b) *preventing the entry of a person into that or any other market; or*
- (c) *detering or preventing a person from engaging in competitive conduct in that or any other market."*

24. The essential elements which are required to establish a contravention of section 46 are:

- (i) an identification of the relevant market;
- (ii) whether the corporation in question has a substantial degree of power in that market;
- (iii) whether the corporation in question by its conduct has taken advantage of its power in that market;
- (iv) whether the conduct of the corporation in question has been engaged in for one of the proscribed or stated purposes.

25. It is important to note that the "power" referred to in section 46 may exist through SKY alone or alternatively aggregated through a group of companies which are related to SKY, eg, TAB and 2KY.
26. It is also to be noted that section 46(3) provides that in determining the degree of power that a corporation has in a market the Court shall have regard to the extent to which the conduct of that corporation is constrained by the conduct of competitors or potential competitors, or persons to whom or from that corporation acquires or supplies goods or services in that market. Section 46(4) provides that a reference to a "market" is a reference to market for goods or services; a reference to "power" is a reference to market power; and a reference to "power in relation to a market" is a reference to power or conduct in that market as either a supplier or acquirer of goods or services.
27. Section 46(7) provides that a proscribed purpose may be inferred from the conduct of a corporation or from any other relevant circumstances. Section 46 must also be looked at in conjunction with section 4E which provides:
- "[For] the purposes of this Act ... "market" means a market in Australia and when used in relation to any goods or services, includes a market for those goods or services... that are substitutable for, or otherwise competitive with the first mentioned goods or services."*
28. For present purposes, identifying the relevant market in which SKY operates is not necessarily straight forward.
29. The relevant market in which SKY operates could simply be the market for the provision and acquisition of live television racing services. This market definition is supported by the fact that radio broadcast racing services and the extremely limited free to air television coverage of live racing are not good substitutes for the continuous comprehensive visual images of race meetings from race tracks all over Australia as well as by the fact that entrance into the market for live racing broadcast face very high barriers to entry. These take the form of long term and exclusive contractual arrangements we understand that SKY has with various parties including the race track operators, satellite owners and the huge capital investment which is necessary for the establishment of infrastructure required for the provision of such services. This factor is also important in determining whether SKY/TAB has a substantial degree of power in the market for live TV racing broadcasts.
30. However, it is also possible that the relevant market may also include radio broadcasting of live racing services. Arguably, the relevant market could be even broader and extend to a general market for sports broadcasting in Australia. Clearly, the broader the definition of the market the more difficult it becomes to demonstrate that SKY/TAB has a substantial degree of power in that market.
31. In determining what is the relevant market, the issue of substitutability is of particular importance. Section 4E of the *Trade Practices Act* provides that market means a market in Australia for goods or services that are substitutable for, or otherwise competitive with, other goods or services. Accordingly, if it was

established that radio racing broadcasts were substitutable for live TV racing broadcasts then those matters would be considered to be part of the same market. Substitutability is to be considered over the long run. That is, if the price of SKY's transmissions services increased significantly would its customers move from TV to live radio broadcasts.

32. In our opinion, for the reasons outlined above, the relevant market is most likely to be the provision of a live racing television service for the operators of TABs, hotels, racing venues and various pay TV operators throughout Australia. If this analysis is correct then this market is a single product market. In other words, there are no real substitutes for the service which it provides. SKY is a monopolist in this market. Most viewers are likely to watch the program only as an incident of betting and would not, for example, regard live Rugby as an alternative to live racing. In other words, there are no realistic alternatives. The service exists in every TAB outlet and racing venues as well as many hotels, and it is essential for those parties' operations. Even if we are wrong and the market includes radio broadcast, we do not consider it materially alters our analysis as the radio coverage is provided by radio 2KY which is owned by TAB. As mentioned above, market power may be aggregated across a group of related companies.

33. Although this conclusion may be open to argument, for the purpose of the remainder of this letter, we have assumed that the relevant market is the market for live racing television services. Further, for the reasons set out below, we do not consider much turns on market definition.

34. In a leading High Court decision dealing with section 46, *Queensland Wire Industries Pty Limited v Broken Hill Proprietary Co Limited* (1989) 167 CLR 177, his Honour Mason CJ and Wilson J defined market power as:

"... the ability of a firm to raise prices above the supply costs without rivals taking away customers in due time, supply costs being the minimum cost an efficient firm would incur in producing the product."

35. Their Honours noted that a large market share may be evidence of market power but they also observed that:

"... the ease with which competitors would be able to enter the market must also be considered. It is only when for some reason it is not rational or possible for new entrants to participate in the market that a firm can have market power... there must be barriers to entry."

36. In *Eastern Express Pty Limited v General Newspapers Pty Limited* (1992) 35 FCR 43 at 63 their Honours Lockhart and Gummow JJ said:

"Market power is concerned with power which enables a corporation to behave independently of competition and of competitive prices in a relevant market. The primary considerations in determining market power must be taken to be whether there are barriers to entry into the relevant market... to what extent is it rational or possible for new entrants to enter the market?"

37. Further "*substantial*" in the context of section 46(1) means "*a considerable or large degree of such power*". It has also been said that the power is substantial when it is "*real or of substance*" and "*more than trivial or minimal*".
38. On the basis of the principles and matters referred to above, including the fact that radio broadcasting services are a poor substitute to live TV broadcasts, the significant barriers to entry and the fact that SKY is essentially a monopolist in the provision of live television racing broadcasts, we consider that SKY is likely to have substantial degree of power in the market for live TV racing broadcasts. In addition to these matters, the fact that SKY uses a particular hotel's beer literage sales as the basis of calculating its fees (on this basis SKY's fees for some hotels runs into the thousands of dollars) when compared to a private individual taking supply of SKY racing as part of a vast package of other programs from Foxtel or other Pay TV operators for a total cost of approximately \$50 per month, also indicates that SKY/TAB has a substantial degree of market power.
39. In addition to proving that SKY/TAB has a substantial degree of power in the live TV racing broadcasting market, as referred to above, we must also establish that SKY/TAB has acted in such a way so as to "*take advantage of that power*".
40. In the present case, the possible manifestations of the taking advantage of SKY's market power, has been identified in the report completed by Hank Spier and includes:
- a "take it or leave it" attitude to contract negotiations;
 - use of overseas standard form contracts;
 - SKY's refusal to negotiate on essential terms;
 - SKY's refusal to take into account the different commercial circumstances between small and large customers and in particular small customers in regional NSW, the use of an inappropriate basis for charging namely beer literage;
 - SKY's high charges which have "no relationship to commercial reality";
 - forcing customers to meet all establishment and running costs – with the result that many make a loss on their gaming operations;
 - the different terms and conditions imposed on operators in different states which reflect the different market power relationships between the operators and SKY rather than the different commercial realities;
 - SKY's threats to take away services without any compensation for large establishment costs;
 - generally using the TAB service as a commercial lever.

41. On the assumption that the matters identified by Hank Spier can be sufficiently established by documentary and/or other evidence, then it seems clear to us that SKY has "*taken advantage*" of its market power. This is because this conduct can usually only be engaged in by persons enjoying market power.
42. Notwithstanding this, in order to prove that SKY has breached section 46 we must also establish that SKY has taken advantage of its market power for one of the proscribed purposes. As such, the concept of power in section 46(1) is concerned not just with the *effect* of the conduct in question, but critically with the *purpose* in the sense of motivation and reason: *Melway Publishing Pty Limited v Robert Hicks Pty Limited* (1999) ATPR 41-693. We note that many commentators regard the "*purpose*" requirement as operating to totally neuter the effectiveness of section 46 and that the *Dawson Review* has received a number of submissions calling for the abolition of this requirement through legislative amendment. For now, this requirement remains and typically presents itself as an insoluble stumbling block in maintaining successful actions under section 46.
43. As mentioned above, there are three prohibited purposes stipulated in section 46, they are:
- (a) "*[eliminating] or substantially damaging a competitor of the Corporation or a body corporate that is related to that body corporate in that or any other market;*
 - (b) *preventing the entry of a person into that or any other market; or*
 - (c) *detering or preventing a person from engaging in competitive conduct in that or any other market.*"
44. As SKY has no actual competitors (or even potential competitors in the short term given the barriers to entry) in the relevant market, the purpose identified in sub-paragraph (a) above is not relevant. Further, the conduct engaged in by SKY, namely charging high prices to AHA members, could not in practical terms and in any event be aimed at eliminating or substantially damaging any potential competitor to SKY. Similarly, the purpose identified in sub-paragraph (b) above is not relevant as again the conduct of charging high prices will not prevent the entry of a person into the relevant market. In fact, the extraction of monopoly prices would usually attract new persons into the market if barriers to entry were not as high as they are in this case. Conversely, it is usually the charging of low prices, below marginal cost, which is attacked under sections 46 as predatory pricing. If it could be proved that the prices charged are so high as to constitute a constructive refusal to supply the broadcast services – on the basis that it makes no economic sense to acquire the service, even though it is necessary to satisfy patrons' requirements – an argument may be available that the pricing practices involve giving effect to one of the prohibited purposes. However, we do not understand this to be the case in that the charges are overly high but most hoteliers are not actually losing money simply by reason of these high charges.

45. The basic premise behind the pricing structure would seem to be:
- (a) that the hotels' numerous patrons are able to view the SKY Racing broadcast together under one roof and this, coupled with the fact that it attracts patrons to the hotels, warrants a higher price than is the case where an individual subscriber views the program in his/her living room;
 - (b) that there is at least some likely economic relationship between beer sales and the use of the service; and
 - (c) the pricing is at a level where it is still economical for most hoteliers to acquire the service even though the returns from operating a PubTAB (and purchasing the associated SKY program) are generally unsatisfactory.

We do not consider that giving effect to this pricing practice is likely to involve a breach of section 46.

46. Accordingly, the only relevant proscribed purpose that we can identify is that identified in section 46(1)(c) which provides that a corporation must not take advantage of its market power for the purpose of "*detering or preventing a person from engaging in competitive conduct in any market*". To put it in another way, it must be shown that one of the reasons for engaging in the conduct referred to above is to harm competition in the market in which the hoteliers operate, or to harm competitors of SKY.
47. It may be possible to argue that SKY's conduct (in particular, its refusal to negotiate and calculating its fees for access to its racing channel based upon beer literage sales) is undertaken for the substantial *purpose* of preventing or deterring the hotels from competing with its non-hotel competitors such as licensed clubs and/or TAB "*shopfront*" agencies throughout NSW. In order to demonstrate that SKY/TAB had this purpose when engaging in the conduct referred to above it is useful to understand why SKY would rationally have such a purpose. We would also need to understand what prices are charged by SKY to (non hotel) competitors of the hotels.
48. It should also be considered whether SKY's conduct is directed to hindering the hotels' ability to compete in their own market by giving effect to a pricing policy based on beer literage sales. This may operate to prevent those hotels which have large beer sales yet disproportionately small revenue from the provision of PubTAB services from competing, at least at particular times (eg Saturday afternoons), with other hotels, licensed clubs and/or TAB outlets.
49. In relation to the issue of competition between hotels and TAB shopfront outlets, it may be that SKY wish to prevent the hotels from competing with these TAB outlets because of SKY's direct ownership link with TAB. However, this possible argument will have less force if most or all TAB outlets are not directly owned by TAB but rather are owned and operated as franchises. Further we understand from comments made by Messrs Spier and Miller that TAB is looking to progressively phase out these outlets. This intention is obviously inconsistent with holding the

purpose of disadvantaging the hotels vis-à-vis the TAB outlets. As we are instructed, the returns to the TAB from PubTAB are superior than those obtained by the shopfronts. Is this simply because of the super normal profits extracted from the PubTABS operated by the Hotels?

50. Are you able to provide us with any additional reasons why SKY would wish to prevent or deter the hotels competing with their competitors? It would seem to us that the most likely purpose behind the tariff formula is to maximise profits. We do not consider this to be a prohibited purpose without something more being shown.
51. Until its relatively recent repeal, section 49 of the *Trade Practices Act* prohibited discriminatory and anti-competitive pricing practices, that is, charging different prices for the same product to different customers (or in different markets to the same customers) was prohibited under the Act. Following the repeal of this provision, these practices are only now prohibited under section 46 where they fall within the general requirements outlined above. It is notable that hoteliers may receive the same service via Foxtel Pay TV subscription for a fraction of the price charged to that same hotelier by Foxtel for re-transmission to its patrons. *Prima facie*, this gives rise to the suggestion of anti-competitive price discrimination. There is, however, a considerable body of opinion and US case law that shows that this type of pricing, often referred to as Ramsey pricing or pricing in accordance with individual demand and supply cost, is not anti-competitive. Although the gross differences between the prices charged by Foxtel and SKY obviously suggest that cost of providing the services is not reflected in the price differences, it also needs to be borne in mind that the SKY Racing services are used as a way of attracting patrons to the hotel and thus increasing the returns to the hotelier through the sales of its own products, namely alcohol and other leisure services. It is also important to note that there is some attempt to align pricing with the benefits to be derived by the hotels from acquiring the SKY Racing services in that one would expect there to be some rough correlation between the number of patrons and hence returns to a hotel from beer sales and use of the PubTAB and associated SKY Racing services. Obviously, every hotel will have different characteristics and customer base and this analysis may not run true in every instance. Nonetheless, as a basic methodology we do not consider the pricing formula to be inherently anti-competitive. Are you in a position to know whether super normal *profits* are made by SKY from the supply of services to the hotels?
52. Accordingly, in order to further advance any claim under section 46, further substantial evidence will be required, especially in relation to the issue of SKY's unlawful purpose. As indicated above, such evidence can be inferred from SKY's conduct or from any other relevant circumstances.
53. Further, proceedings commenced for breach of section 46 are typically extremely expensive and difficult to conduct. It should be noted that the ACCC and others have recently attempted to litigate against certain corporations pursuant to section 46 and have failed on nearly every occasion. Unless the further evidence that we require can be found we do not consider that proceedings be commenced for breach of section 46.

Breach of section 151AJ(2)
- Anti-competitive conduct in a Telecommunications market

54. Section 151AK is contained within Part XIB of the *Trade Practices Act* which sets up a special regime for regulating anti-competitive conduct in the telecommunications industry. It is possible that SKY, by providing transmission services to its customers via satellite, falls within the telecommunications industry and therefore potentially falls within the operation of Part XIB.
55. Part XIB and in particular section 151AJ(2), essentially repeats the misuse of market power provisions contained in section 46 except that the purpose element in section 46 is replaced by a requirement to show only the effect of a substantial lessening of competition. Accordingly, this provision may be of particular benefit to the AHA and its members if we can establish that these arrangement had an anti-competitive effect in a telecommunications market.
56. Section 151AJ(2) provides:
- "A carrier or carriage service provider engages in any competitive conduct if the carrier or carriage service provider:*
- (a) *has a substantial degree of power in a telecommunications market; and*
- (b) *takes advantage of that power with the effect of substantially lessening competition in that market or any other telecommunications market."*
57. Accordingly, there are three key elements that must be satisfied:
- (i) is SKY a "carrier" or "carriage service provider"?
- (ii) does SKY have a substantial degree of power in a "telecommunications market"?
- (iii) has SKY taken advantage of its power with the effect of substantially lessening competition in a telecommunications market?
58. In addition to these matters, proceedings cannot be commenced by a private party unless the ACCC has previously issued a Competition Notice to that party stating that that party has engaged in anti-competitive conduct in a telecommunications market. Because of this requirement, we do not expect that it is likely to provide the AHA, or its members, with any remedy unless we can cause the ACCC to issue a relevant competition notice. This has proven an incredibly difficult exercise for a number of persons with more obvious claims over the last few years.
59. Nevertheless, for the sake of completeness, we outline below the operation and applicability of pursuing an action for breach of section 151AK.

60. Although the telecommunications specific laws have been in affect since 1997, there have only been two cases brought under section 151AJ(2) and both were discontinued before conclusion. Therefore, it is difficult to assess how the law may be interpreted.
61. Nevertheless, is possible that SKY would be considered to be a carriage service provider as it is a broadcaster of television programs. A "carriage service provider" is defined in the *Telecommunications Act 1997* to be "a person who supplies or proposes to supply a listed carriage service to the public using a network unit owned by one or, more carriers, or a network unit in relation to which a nominated carrier declaration is in force."
62. "Telecommunications market" is defined in section 151 AF of the *Trade Practices Act* to be a market in which carriage services, good and services for use in carriage services or access to facilities are supplied or acquired.
63. Further a "carriage service" is broadly defined as a service for carrying communications by means of guided and/or unguided electromagnetic energy.
64. A "facility" is any part of the infrastructure of a telecommunications network or any line, equipment, apparatus, tower, mast, antenna, tunnel, duct, hole, pit, or other structure or thing used or for the use in or in connection with a telecommunications network. Accordingly, while it is not certain, SKY, by broadcasting TV services is likely to be a "carriage service provider" and operative in a telecommunications market.
65. The second element that is required to be satisfied is that SKY must a substantial degree of power in a telecommunications market. For the same reason as identified in the previous section dealing with section 46 it is also possible that SKY would be considered to have the requisite substantial degree of power in a telecommunications market as it is the current dominant provider of broadcast racing services.
66. The real question is whether SKY's conduct can be said to have the effect of substantially lessening competition in a telecommunications market.
67. First, we must establish in which market the lessening of competition is alleged to occur? Is the effected market:
- (i) the market for broadcast racing services; or
 - (ii) the market in which operators of recreational facilities, such as hotels, clubs, and bars engage in business; or
 - (iii) the market for gaming/betting services, such as TAB agencies, PubTABs and telephone betting?

Only the first of these markets is a "telecommunications market" as contemplated by the *Trade Practices Act*.

68. Secondly, how is the substantial lessening of competition manifested? Has SKY's conduct acted to reduce the amount of competition between PubTABs and other TAB agencies or has it caused a reduction in the competition for broadcasting racing services as a consequence of restrictions on the purchasing choices available to hotels vis-à-vis PubTABs?
69. Only if it can be shown that SKY's conduct has caused reduced competition in broadcasting racing services between acquires or potential acquirers of these services, can SKY be seen to have breached section 151AJ.
70. AS mentioned above, the final and most important difficulty in an action involving Part IXB is that proceedings can only be commenced if the alleged conduct is of a kind dealt within a Part A Competition Notice issued by the ACCC that was in force at the time when the conduct occurred. In addition to these matters, these types of actions are notoriously expensive and difficult to prove. Accordingly, at this stage and without further information, our recommendation is that this type of action not be pursued.

Breach of section 47 of the Trade Practices Act – Third line forcing

71. Section 47(6) of the *Trade Practices Act* prohibits conduct which amounts to third line forcing.
72. This prohibition is a so called "*per se*" or strict prohibition. Accordingly, the conduct is prohibited regardless of its effect on competition. That is, in contrast to some other prohibitions referred to in the *Trade Practices Act* which require an analysis to be undertaken of the consequences of the conduct on competition. Accordingly, issues such as market definition are less directly relevant to the analysis.
73. Section 47(6) provides that:
- "A corporation engages in the practice of exclusive dealing if the corporation... supplies or offers to supply goods or services ... on the condition that a person to whom the corporation supplies or offers or proposes to supply the goods or services ... will acquire goods or services of a particular kind or description directly or indirectly from another person."*
74. In essence, third line forcing involves a company, in supplying its goods or services, imposing a condition that the purchaser must also acquire the goods or services of a third person. Offering to supply goods or services on such a condition is known as third line forcing. It should also be noted that third line forcing will also occur if a company offers to give a discount, allowance or rebate on the condition that the purchaser will acquire goods or services from a third party. Essentially, it involves A, (the supplier of the tying product); B, (the party whose product is "*forced*"); and C, (the acquirer) and the supply of two different products.
75. We are instructed by JDK Legal that TAB will only supply PubTAB to venues which also take transmission services from SKY or vice versa, that is, SKY will

only provide its transmission services to venues which also take supply of services from TAB.

76. If SKY and TAB were not related companies then this arrangement would be likely to constitute third line forcing, however, section 47(12) of the *Trade Practices Act* provides that arrangements do not amount to third line forcing if the arrangements, as in this instance, are between parties that are related to each other.

77. There is also a general prohibition contained in section 47 in relation to anti-competitive or conditional supply agreements. Although these may have some potential application, a breach can only be demonstrated where the particular agreement has the purpose or effect of substantially lessening competition in a relevant market. Essentially, for the reasons outlined in the section 46 analysis above, we do not consider it likely that valid claims under this provision will be available.

(a) *Contracts, arrangements or understandings which substantially lessen competition (section 45)*

78. There is a possibility that an action based in breach of section 45 of the *Trade Practices Act* exists as a result of the exclusive arrangements between SKY and each of the racing venue owners (eg the Australian Jockey Club). Section 45 prohibits any contract, arrangement or understanding which has the purpose or likely effect of substantially lessening competition as however, as we have not been provided with copies of any relevant agreements or details of such agreements, it is difficult at this stage to speculate of the effect or likely effect of these agreements. Nevertheless, it is an area that we recommend be further explored. It needs to be borne in mind, however, that the likely remedies flowing from a breach of section 45 may not be particularly useful to the AHA or its members. The most likely remedy would be to declare void the offending agreement. This is unlikely to prove practically useful to the hotels for several reasons.

(b) *Exclusionary Provisions (Section 45 read with section 4D)*

79. The *Trade Practices Act* prohibits agreements, arrangements or understandings between competitors which have the *purpose* of preventing, restricting or limiting the supply of goods or services to a particular person or group of persons.

80. This means that in most cases a company, acting by itself, could legally decide not to deal with a particular business or individual. The only circumstances where this might be illegal would be where it involved a "misuse of market power" pursuant to section 46 (which was addressed above).

81. For conduct to amount to a breach of section 45/ 4D the following elements need to be established:

- (i) a contract agreement or understanding between two or more competitors; and
- (ii) that the parties' commonly held purpose was to boycott another party.

82. For present purposes, we would need to establish that both SKY and Foxtel are competitive with each other in the market for broadcasting services and both parties must hold the same purpose of boycotting another party.
83. We note that the relevant purpose need not be the *only* purpose, but it must be a substantial purpose.
84. Evidence of purpose can be difficult to obtain. Often, in the absence of a "smoking gun" internal memo, the court will imply a purpose from a party's conduct. However, where other plausible purposes exist, a court may be reluctant to find the necessary purpose.
85. In relation to whether or not SKY and Foxtel are competitors, it could be argued that they each operate to some extent at the same functional level in that SKY and Foxtel both supply broadcasting services to customers. Foxtel supplies a bundled product of multi programming to households and other persons, including hotels. SKY Racing, on the other hand, is supplied directly to hotels by SKY. It is, however, critical that SKY provides the SKY Racing program to Foxtel presumably under licence for the purpose of re-supply to Foxtel's own subscribers, but not to hotels. Because of this, they are more likely to be regarded as having a "vertical" relationship (i.e. supplier and re-supplier) rather than being competitive with each other, as required by section 4D. Further, the *Trade Practices Act* contains anti-overlap provisions that operate to take certain vertical re-supply restriction out of the per se provisions. In this case, SKY is supplying Foxtel with the program on the condition that it not re-supply the program to hotels or, alternatively, SKY is reserving to itself the exclusive right to supply hotels with SKY Racing on its own terms. We do not consider this to involve a boycott or exclusionary provision.
86. For this reason and several others that involve fairly complex arguments revolving around the interpretation of the relevant provisions of the *Trade Practices Act*, we do not consider this cause of action to have any reasonable prospects of success.

(c) Unconscionable conduct (sections 51AA and 51AC)

Section 51AA

87. Section 51AA of the *Trade Practices Act* provides that "*a corporation must not in trade or commerce, engage in conduct that is unconscionable within the meaning of the unwritten law, from time to time of the States and Territories.*"
88. The phrase "unwritten law" essentially means the law as developed by the courts, as opposed to the law as enacted by legislation. As such the following elements need to be proved:
- the party seeking relief must, at the time of entering into the transaction, suffer from a *special disability* vis-à-vis the other party;
 - the other party must know of the special disability;

- the other party has unconscionably exploited the special disadvantage of the party seeking relief.
89. Once the party seeking relief proves these elements, the onus shifts to the other party to show that the transaction was fair, just and reasonable.
90. Clearly, the notion of a "special disadvantage" is fundamental to section 51AA. While factors such as lack of education, poverty, age, infirmity or drunkenness are usually regarded as factors going to indicate a special disadvantage, recent case law suggests a willingness to expand the notion of a special disability see: *Pritchard v Raccage Pty Limited* (1997) ATPR 41-554 and *Olex Focas Pty Limited v Skoda Export Co Limited* (1997) 134 FLR 331. We do not however consider that the categories of special disability that have evolved in the case law or the emerging tendency to broaden these categories has reached the point where the AHA or the members would have a claim under this section.
91. In any event, we consider that the better action for SKY's alleged unconscionable conduct lie with section 51AC and do not to consider that section 51AA is likely to represent a viable cause of action to the AHA or any of its members..

Section 51AC

92. In 1998 section 51AC was inserted into the *Trade Practices Act* following substantial lobbying and a further series of reports that concluded that the *Trade Practices Act* was generally ineffective in providing a remedy for small businesses for unconscionable conduct in the course of commercial transactions. Section 51AC is aimed at providing small businesses better access to actions for unconscionability than otherwise available under the general law or section 51AA referred to above. These provision apply where the value of services supplied or acquired do not exceed \$3million and involve, at least one corporation (as opposed to other legal entities) in the transaction.
93. We consider that this section provides certain AHA members with their strongest potential action against SKY, although we will need to gather further documents and information which support the allegations of unconscionability to confirm this view.
94. Further, a action based on section 51AC may importantly be of particular interest to the ACCC. As indicated above, the section is relatively novel and as a consequence there is little case law which explores the operation and scope its application and remedies available for breach. To date, the ACCC has commenced a number of proceedings on behalf of certain aggrieved parties seeking relief under section 51AC. However, on each occasion the proceedings did not run to a contested trial and accordingly the particular proceedings failed to clearly enunciate the law and operation of section 51AC nor set the positive precedent that the ACCC was obviously hoping for. On this basis, there is some hope that this matter can be raised and ultimately run, if possible, by the ACCC, on behalf of some or all of the AHA's members. Clearly this has the benefit that the ACCC will incur the necessary legal costs. Although, if this was to occur the AHA and its members would lose control of the proceedings. It might, therefore, be preferable for any

proceedings under this provision to be conducted directly at the suit the AHA or more probably by a particularly aggrieved hoteliers with the best cause of action. There are also a wide range of potential remedies available for breach of these provisions that could be relevant in the current circumstances.

95. At a general level, there are a number of facts which we consider confer on SKY the ability to act in an unconscionable manner. They are:

- the dominant bargaining position of SKY vis-à-vis each of the AHA members;
- the fact that SKY is the sole provider of live TV racing broadcasts to hotels, licensed clubs and racing venues throughout Australia (presumably through its exclusive agreements with racing venue owners etc);
- the fact that SKY is a related company to TAB and 2KY; and
- to many AHA members, access to the SKY Racing service is essential to their respective businesses.

96. At a more particular level, we will need to examine the particular conduct involving certain individual AHA members and how the factors referred to above have been used in an unconscionable way by SKY. For the purpose of this letter we have used the example of SKY's dealings with the Harbord Hotel. We do not know whether the experience of the Harbord Hotel is unique and would appreciate hearing from you on this question.

97. Section 51AC(1) provides that:

"A corporation must not, in trade or commerce, in connection with the supply or possible supply of goods or services to a person or corporation (other than a listed public company) engage in conduct that is, in all the circumstances, unconscionable."

98. Helpfully, the *Trade Practices Act*, in section 51AC(3), provides that a Court may have regard to some or all of the following matters when determining whether the relevant conduct is unconscionable in all the circumstances:

- (i) *The relative strengths of the bargaining positions of the supplier and the business consumer.*

Clearly, vis-à-vis AHA members, SKY is in a dominant position in relation to bargaining strength. SKY enjoys the superior bargaining strength of not only financial and material resources, but also more importantly from its monopoly position and relationship with TAB. As mentioned above, SKY is the sole provider of live racing TV transmission services throughout Australia. Further, live radio racing broadcast is no real substitute for live TV broadcast and there are high barriers to entry into the market in the form of exclusive contractual arrangements between SKY and the racing venue owners.

- (ii) *Whether, as a result of the conduct engaged in by the supplier, the business consumer was required to comply with conditions that were not reasonably necessary for the protection of the legitimate interests of the supplier.*

Due to the limited case law concerning section 51AC it is not altogether clear what facts might be relevant to determine the conditions that are reasonably necessary for the protection of the legitimate interests of SKY. However, we may be able to point to certain provisions of the SKY licence agreement or ancillary conduct in relation to those provision which we say are not reasonably necessary for the protection of SKY's legitimate interest. We obviously need to further consider this issue.

Further, we would argue that the direct linking of SKY's fees charged to AHA members to beer literage sales, especially in situations where the particular hotel has large beer literage sales yet relatively low revenue from betting related services, is not reasonably necessary for the protection of SKY's legitimate commercial interest. In this regard, it might also be relevant that if the hotels could take the re-supply of SKY Racing Channel from Foxtel the cost of obtaining the service would be substantially lower. Further, it would appear from SKY's dealings with the Harbord Hotel that its strict insistence on contractual rights in prejudicial circumstances might be seen to evidence this factor.

- (iii) *Whether any undue influence or pressure was exerted on, or any unfair tactics were used against, the business consumer or a person acting on behalf of the business consumer by the supplier or a person acting on behalf of the supplier in relation to the supply or possible supply of the goods or services.*

Clearly, in relation to this factor we need to examine the particular circumstances surrounding the particular conduct and dealings between SKY and any particular hotel.

Based on the information we have been provided in relation to the Harbord Hotel it is possible that we would be able to demonstrate that SKY has in fact used undue influence or engaged in unfair tactics. The relevant facts and circumstances involving the Harbord Hotel are:

- The Harbord Hotel licence agreement with SKY had ended some time ago but because of renovations that were being carried out at the hotel, including renovations to the bar trading area and the PubTab area, the representative from SKY orally agreed that the negotiations and signing of a new agreement would not take place until the renovations had been completed.
- Notwithstanding this agreement, SKY resiled from this position at a particularly difficult time and required the hotel to immediately execute a now 5 year agreement on less favourable terms before the

renovations are complete or the transmissions services would be immediately terminated.

Subject to further details and evidence it may be possible to argue that the timing of the dealings described above and the manner in which these dealings were conducted involved duress and unfair commercial tactics and pressure. The correspondence would tend to suggest that SKY has taken advantage of the fact that it is the sole provider of transmission services of live racing feed in Australia and that an interruption to this service would have obvious adverse consequences to the owner of the hotel.

Other relevant factors could also include the factors referred to above in relation to whether SKY has "taken advantage" of its market power, including:

- the take it or leave it attitude to contracts;
- SKY's refusal to negotiate on essential terms;
- SKY's refusal to take into account the different commercial circumstances between small and large customers and in particular small customers in regional NSW, the use of an inappropriate basis for charging namely beer literage;
- SKY's high charges which have no relationship to commercial reality;
- forcing customers to meet all establishment and running costs – with the result that many make a loss on their gaming operations;
- the different terms and conditions imposed on operators in different states which reflect the different market power relationships between the operators and SKY rather than the different commercial realities;
- SKY's threats to take away services without any compensation for large establishment costs;
- generally using the Pub TAB service as a commercial lever.

(iv) *The amount for which, in the circumstances under which, the business consumer could have acquired identical or equivalent goods or services from a person other than the supplier.*

This factor invites the Court to consider whether the hotels could have sought an equivalent service elsewhere. As mentioned above, SKY is essentially the sole provider of live TV racing services to hotels in Australia. Therefore, the hotels have no alternative supply possibilities.

Clearly, SKY is aware of this and consequently uses this fact to its advantage to obtain a significantly better deal than the market might otherwise deliver to it if it had competitors.

Whether this amounts to unconscionable conduct may depend on other factors such as the willingness of SKY to negotiate and the extent to which SKY has acted in good faith.

Further, the fact that if Foxtel was entitled to supply the hotels with its SKY racing channel, the hotels would be expected to be able take supply of that product for a substantially lower price (this suggests that this factor may be relevant in the present instance).

- (v) *The extent to which the supplier's conduct toward the business consumer was consistent with the supplier's conduct in similar transactions between the supplier and other like business consumers.*

Without the benefit of any case law, it is difficult to understand the scope and extent to which this factor is relevant. Nevertheless, on SKY's own information, its fees vary from industry to industry because "each venue's trading figures vary greatly". Our comments above on differential pricing are also relevant to this issue. We also would appreciate understanding the pricing relevant to licensed clubs and other customers who might be seen to compete with the hotels.

- (vi) *The extent to which the supplier was willing to negotiate the terms and conditions of any contract for the supply of goods or services with the business consumer.*

As mentioned above, we are instructed that SKY is essentially unwilling to negotiate any of the terms and conditions of its licence agreements with individual hotels.

99. Clearly, some of the above factors are of particular relevance to the dealings between SKY and the AHA and its members and are evidenced in the dealings covering the Harbord Hotel.
100. Obviously, in assessing the merits of any action for breach of Section 51AC, we will need to review all the relevant dealings and all the relevant documents. On the basis of the material to hand, an action against SKY/TAB for breach of section 51AC looks to have the best prospects of success. Having said this, any such action would probably need to be assessed on a member by member basis and is unlikely to be available to the AHA as a plaintiff in its own right. At best, the AHA might be granted leave to intervene or be a representative claimant on behalf of a number of hotels.
101. Notwithstanding these comments, given the breadth of section 51AC, its novelty and the analysis set out above, we suggest that this provision is likely to provide the AHA and its members with its best prospects.

102. We note that a breach of section 51AC gives rise to a broad range of remedies, including injunctions, damages, declarations, orders varying or voiding transactions and other like remedies. This is significant because it is not altogether clear what we would be asking a Court to do if we commenced proceedings on behalf of one or more publicans. We consider it unlikely that the Court will rewrite the terms of any standard form agreements between SKY and the hotels, or require a particular standard form agreement to be put into place. Nonetheless, it is possible that certain elements of the existing standard form agreement may be found to be unconscionable or particular dealings involving particular hotels might be found to be unconscionable thus giving rise to a claim for damages or other consequential relief for individual member hotels. Rather than speculate on these matters at this stage, we would first need to identify with precision the precise nature of any cause of action available under section 51AC in respect of any particular hotel or group of hotels and what legal and/or commercial outcomes any claimant would seek to achieve.

General Strategy

We have gone into significant detail in considering the possible causes of action that may be available to the AHA and/or its members for breach of various provisions of Part IV and V of the *Trade Practices Act*. Although many of the causes of action we have considered have been dismissed as not having good prospects, our views are, of course, qualified by the absence of instructions and/or evidence in relation to a number of matters. We do, however, consider that we have had access to sufficient material to form the view that the cause of action with the most likely prospects (that can be most economically run) arises out of the unconscionability provisions.

Leaving aside the numerous arguments referred to above as to why various of the causes of action may not be available, the practical reality is that maintaining a proceeding in court on behalf of the AHA or any member is likely to be a long, expensive and ultimately difficult venture. Further, any victory might be pyrrhic as there may not be any practically useful remedy; the result may take several years to materialise and be subject to numerous appeals.

Recent experience dictates that Part IV matters either fail at the first hurdle or end up in the High Court. Further, we consider it unlikely that the contractual and other arrangements underpinning the provision of the SKY Racing program and PubTAB to the hotels will be characterised by fundamental structural illegalities so as to breach to the *Trade Practices Act*. We hold this view because it is highly likely that extensive legal advice has been obtained in order to ensure compliance with the *Trade Practices Act*. For this reason, we consider that our efforts should be focused towards finding good examples of hoteliers that have been meted out harsh treatment at the hands of SKY/TAB along the lines of the conduct evidenced in the communications passing between the Harbord Hotel and representatives of SKY. If we are able to select a number of publicans, preferably with different characteristics and different fee structures given the size of their businesses and beer literage sales (and preferably revenue derived from the Pub TAB service by way of commissions) we consider that a cause of action with reasonable prospects might be able to be brought against SKY and/or TAB.

Whilst the ultimate success, benefit or otherwise of any proceedings is difficult to predict with any degree of certainty, we would expect that the proceedings may have the effect of creating

an environment in which SKY/TAB might start to adopt less aggressive and inflexible positions in its dealings with the hotels.

We also recommend that this strategy be employed in tandem with the authorisation application which, if granted, will provide a counterbalance to the superior bargaining position that is currently enjoyed by SKY. In our view, the ability of the hotels to collectively negotiate will result in better outcomes for the AHA and its members and should be seen as the primary strategy. If the authorisation is not granted, we would recommend consideration be given to seeking a review in the Australian Competition Tribunal.

Needless to say, the recommendations as to strategy and conclusions reached in this letter in relation to the availability or non-availability of various causes of action are predicated on the material that we have been provided with. It is possible that upon the provision of further material our views might change, although we consider this unlikely in relation to the causes of action based on section 46, section 151AK and section 45 read together with section 4D of the *Trade Practices Act*. There is however the prospect that a reasonable cause of action for a breach of the general prohibition against anti-competitive dealings might be available. However, this cause of action require proof of the substantial lessening of competition in a particular market and is visited with a number of potential difficulties which mirror some of the concerns raised above in relation to section 46 of the Act.

We suggest that a conference be arranged with Senior Counsel to discuss advice and to determine the way forward.

We look forward to hearing from you.

BAKER & MCKENZIE

Dated: 22 August 2002