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18 June 2010

Dr Richard Chadwick
General Manager
Adjudication Branch
Australian Competition & Consumer Commission

"By Email"

Email: adjudication@accc.gov.au
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Dear Dr Chadwick

Exclusive dealing notification N94674, lodged by FOXTEL Management Pty Limited – interested party consultation

TransACT Communications Pty Ltd (TransACT) is pleased to submit a response to the Australian Competition & Consumer Commission (ACCC) in relation to the exclusive dealing notification N94674 (the notification), lodged by FOXTEL Management Pty Limited (Foxtel) and the associated ACCC correspondence to interested parties posted on the ACCC's website.[1]

About TransACT

Since 2001 TransACT has been rolling out a fibre-optic network in the Australian Capital Territory (ACT) region to provide Canberra and Queanbeyan with the next generation of communication services. TransACT's philosophy has always been to operate an open access network. The TransACT network supports a rich array of retail and wholesale telecommunication services. TransACT offers a comprehensive selection of telecommunications products and services including:

- fixed line and mobile telephony;
- high speed broadband;
- broadcast subscription television services featuring a wide choice of channels; and
- demand based video featuring a wide variety of content.

TransACT also works with a range of service and content providers in order to deliver these services. Currently eleven ISPs, including TransACT's own entity (Grapevine Ventures), access TransACT's network to provide broadband services and choice to customers.

TransACT products and services are now available to over 100,000 premises across the ACT and Queanbeyan, directly connected via TransACT's fibre-to-the-premises

[1] http://www.accc.gov.au/content/index.phtml/itemId/926760/fromItemId/776499

(FTTP) network, fibre-to-the-curb (FTTC) very-high speed digital subscriber line (VDSL) network and supplemented by asynchronous digital subscriber line (ADSL) over the unconditioned local loop service (ULLS). Utilising other wholesale access services, such as local carriage service (LCS) and wholesale line rental (WLR), a complete local and long distance phone service is also available in Sydney and south-east NSW including Bega, Berridale, Bombala, Crookwell, Cooma, Goulburn, Gunning, Nowra, Thredbo village and Yass. TransACT also provides its TransMOBILE (mobile telephony) service covering 94% of the Australian population, which is also complemented with its national broadband product through Grapevine Ventures.

Neighbourhood Cable Pty Ltd (NCPL), a wholly owned subsidiary of TransACT, is also investing significantly in the provision of broadband infrastructure, products and services to other areas of Regional and Rural Australia. NCPL is an advanced telecommunications company servicing the Victorian regions of Ballarat, Mildura and Geelong. Committed to delivering high speed cable broadband and entertainment services to regional Australia, NCPL began rolling out a hybrid fibre and coaxial (HFC) network in 1997. Starting in Mildura and later expanding to Ballarat and Geelong, the Neighbourhood Cable network now reaches over 95,000 households across the three regions. NCPL is continuing to invest in the provision of superior broadband services to regional Australia, as seen by its recent announcement to upgrade its HFC network to data over cable service interface specification 3.0 (DOCSIS 3.0) standards.[2]

Foxtel Notification

While TransACT continues to invest in the provision of superior broadband products and services, providing customers with choice, the notification by Foxtel to the ACCC to allow Foxtel subscribers to download additional content to their iQ set top unit, *only to persons who have a Telstra BigPond broadband connection*, defies all logic in relation to enhancing broadband competition. TransACT does not believe this would provide a public benefit that is not outweighed by the detriment.

Currently there are more than 1.6 million Foxtel subscribers[3] of which many would **not** be Telstra BigPond broadband customers. As reported recently by Mr. Paul Budde[4], the total number of residential fixed broadband subscribers crossed the 7.5 million mark in 2010. Mr. Budde continues to state that:

> *"Growth in recent years has been driven by further strong uptake of DSL subscribers, although recent growth has not been as strong as the previous two years as the majority of the market has now made the transition from dial-up to broadband. In the longer term the development of a fibre optic network operated by a National Broadband operator is likely to have a significant impact on the take up of DSL or cable based services."*

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[2] Media release: Neighbourhood Cable to upgrade its network to DOCSIS 3.0; http://www.ncable.net.au/_site/news-single.asp?ID=81

[3] FOXTEL Delivers Solid Earnings Growth Supported by Strong Service Uptake, 11 February 2010

[4] http://www.budde.com.au/Research/Australia-Broadband-Market-Overview-and-Statistics.html, May 2010 (9th Edition)

It is evident from this report that recent growth has been driven by strong uptake of DSL subscribers, which could certainly be attributed to increased competition and end-user choice in the downstream retail internet service provider (ISP) markets. The Budde.com article continues to state that:

> *"Though there are roughly 200 ISPs in Australia the retail broadband market is dominated in Australia by a small number of firms. Telstra provides nearly 45% of services and has roughly four times as many retail subscribers as the second largest player Optus with around 11% of the market. iiNet and TPG and Primus are other major players and each has around a 5% share. The remaining 30% of the market is shared between around 180 small and medium sized providers."*

Taking these percentages, and assuming that of Foxtel's 1.6 million subscribers 45 percent (45%) had a Telstra BigPond broadband connection, this equates to approximately 880,000 existing Foxtel subscribers that could not get access to Foxtel's new *Proposed Service* unless they cancel their broadband subscription with their existing provider and switch to Telstra BigPond or subscribe to an additional broadband connection with Telstra.

This notification is clearly intended to force existing and new Foxtel subscribers to take all their Pay TV and communications services from Telstra and its controlled entities, or they will not be given access to new content offers.

This conduct not only discriminates against existing and new Foxtel subscribers, by forcing them to take a third party service or not be given access to the new content offering, it goes to the heart of the anti-competitive conduct that the *Trade Practices Act 1974 (TPA)* has been legislated to protect.

The *TPA* actually prohibits a common form of exclusive dealing known as 'third line forcing', where 'third line forcing' is the supply of goods or services on condition that the purchaser also acquires goods or services from a third party. While the ACCC may revoke a 'third line forcing' notification, if it is satisfied that the likely benefit to the public will not outweigh the detriment, it is difficult to see how clause 4 of Foxtel's attachment to their notification[5] clearly demonstrates that this is the case.

TransACT is not convinced or satisfied, as stated by Foxtel under clause 4.5 of the notification, that:

> *"The proposed conduct will result in no public detriment in any of the relevant markets."*

TransACT would argue that, the broadband market is a relevant market and the detriment to the public in this market is by way of 'third line forcing' (i.e. Foxtel customers, existing or new, who wish to subscribe to the newly proposed content service, can only do so if they take a Telstra BigPond broadband connection, even if they are happy with their existing broadband provider and did not wish to change).

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5 http://www.accc.gov.au/content/trimFile.phtml?trimFileName=D10+3563574.pdf&trimFileTitle=D10+3563574.pdf&trimFileFromVersionId=931760

Additionally, another form of anti-competitive conduct and exclusive dealing is the supply of goods or services on the condition that the buyer will not acquire, or will limit the acquisition of, goods or services from a competitor of the supplier. While this form of exclusive dealing only breaches the *TPA* when it has the purpose or effect of substantially lessening competition, TransACT would argue that this would be the case in downstream broadband markets as a result of allowing this notification to stand in its current form.

While the notification notes that it is possible that the *Proposed Service* might involve conduct of the kind in section 47(6) and 47(7) of the *TPA*, TransACT suggests that this conduct would be in breach of the *TPA* under subsections 47(6) and 47(7). Additionally, in clause 4 of the notification Foxtel suggests that, while it believes the benefits listed are material, it submits that, *"given there is no anti-competitive detriment arising from the proposed conduct, it is not necessary for FOXTEL to demonstrate more than minimal public benefits".* This statement, in itself, demonstrates the actions of a dominant service provider and its failure to recognise the detriment in downstream broadband markets. To state that there is *no anti-competitive detriment arising from the proposed conduct* totally ignores and discriminates against Foxtel subscribers who wish to acquire the *Proposed Service* but remain with a broadband provider other than Telstra BigPond.

It is also worth noting the lack of transparency in Foxtel's letter of response (26 May 2010)[6] to the ACCC's letter to Foxtel (19 May 2010)[7]. While TransACT can appreciate that certain material may be of a commercial nature, Foxtel don't even indicate, in question 7, whether they approached other internet service providers other than Telstra to discuss the provision of the *Proposed Service.*

If Foxtel was not controlled by Telstra's fifty percent (50%) stake in the company and was independent of Telstra, it would have more of an incentive to engage with as many different broadband providers as possible. This would not only provide the opportunity for competition to deliver the proposed content to end-users, it would also drive better services, more choice, lower prices and therefore greater consumer take-up.

However, the fact that Foxtel is (50%) owned by Telstra Corporation Ltd (Telstra) creates an incentive for each entity to protect each other from competition in downstream markets. While Foxtel notes in its notification that it also competes in a broad market for the acquisition of content rights, together, Foxtel and Telstra effectively control much of the premium content in Australia. This proposal only serves to further entrench their respective market power in broadband, content and Pay TV markets.

The ACCC in its, June 2009, submission to the Department of Broadband and the Digital Economy (DBCDE) on *National Broadband Network: Regulatory Reform for 21st Century Broadband*, stated:

> *"The ACCC submits that exclusive agreements for the supply of content are not necessarily anti-competitive. For example, free-to-air broadcasters have traditionally competed for exclusive content rights as a means of*

[6] Submission by Applicant - 26.05.10; D10+3619228.pdf
[7] ACCC to Applicant re Provision of Further Information - 19.05.10; D10+3615308.pdf

differentiation, without raising competition concerns. ***However, the ACCC notes that if a vertically integrated media or telecommunications company is able to acquire sufficient compelling content on an exclusive basis then competition concerns may arise in the relevant media markets."*** [8] **[emphasis added]**

What's relevant in relation to this Foxtel notification, from the ACCC statement, is where a vertically integrated media or telecommunications company is able to acquire sufficient compelling content on an exclusive basis and then use its market power in other markets, such as the broadband market in this case.

The ACCC also went on to state on page 36 of its submission that:

> *"The ACCC monitors the content sector closely to ensure it is able to identify any emerging competition concerns. Should concerns arise, the ACCC could consider action under Part IV of the TPA, or possibly under Part XIB. Section 45 of the TPA prohibits companies from entering any arrangements that result in a substantial lessening of competition. Section 47 of the TPA prohibits a company from engaging in certain practices that are considered to be exclusive dealing. The ACCC could also consider the use of section 46 which relates to the misuse of market power. To further assist in this regard, the ACCC recommends in section 2.3 of this submission that Part XIB be amended to expressly provide that it applies to content services delivered by carriers and carriage services in telecommunications markets in order to reduce the risk of any challenge to the ACCC's jurisdiction."*

TransACT believes that sections 45, 46 and 47 of the *TPA* all have relevance to this notification and implores the ACCC to consider taking appropriate action and revoke the application in its current form.

Allowing this notification to stand would not only entrench two powerfully integrated entities in their respective markets, it would reduce competition and consumer choice and set a precedent for future third line forcing on the National Broadband Network (including the transitional period and service migration phases to the NBN).

It is also worth noting Foxtel's recent announcement partnering with Microsoft to offer Australians a brand new way of receiving Foxtel (over the internet) and direct to television sets through Xbox 360's online service Xbox LIVE.[9] Foxtel by Xbox LIVE will be accessible in Foxtel areas across Australia to all homes with a broadband internet connection.

The Question is: ***Does the broadband internet connection for the Foxtel by Xbox LIVE service have to be a Telstra BigPond broadband connection?***

Should the ACCC allow this current notification to stand then the precedent will be set for Foxtel to lodge a similar exclusive dealing notification for the Foxtel by Xbox LIVE service.

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[8] ACCC, June 2009, Submission on National Broadband Network: Regulatory Reform for 21st Century Broadband, Exclusive access to content, p.36

[9] FOXTEL - FOXTEL and Microsoft Sign Ground-breaking Xbox Agreement, 20 May 2010

Access to Content

TransACT, as a triple-play provider for more than 10 years now, has found it extremely difficult to operate effectively in the Pay TV market, given the control that Foxtel together with Telstra has had over content. TransACT has experienced numerous issues and roadblocks in its attempts to secure access to premium content from Content Providers, including Foxtel, as a result of exclusive supply and control arrangements.

TransACT has attempted to make contact with content providers such as XYZ Networks and Sky Racing to no avail. Some 14 months ago TransACT received a response from Tabcorp Holdings Limited, in relation to accessing the Sky Racing Channel content, stating:

> *"At this stage we are not looking to expand our partners - should this change I will be in touch."*

In addition, TransACT has made contact with a number of content partners regarding access to new content availability, which has been denied due to exclusivity arrangements. For example, BBC - BBC Knowledge and BBC Cbeebies (as recently as 8/4/2010) and National Geographic - National Geographic WILD (where multiple discussions around Nat Geo WILD and Nat Geo HD have been discussed).

In a letter to TransACT's Chief Executive Officer, in September 2006, Foxtel Chief Executive, Kim Williams AM said:

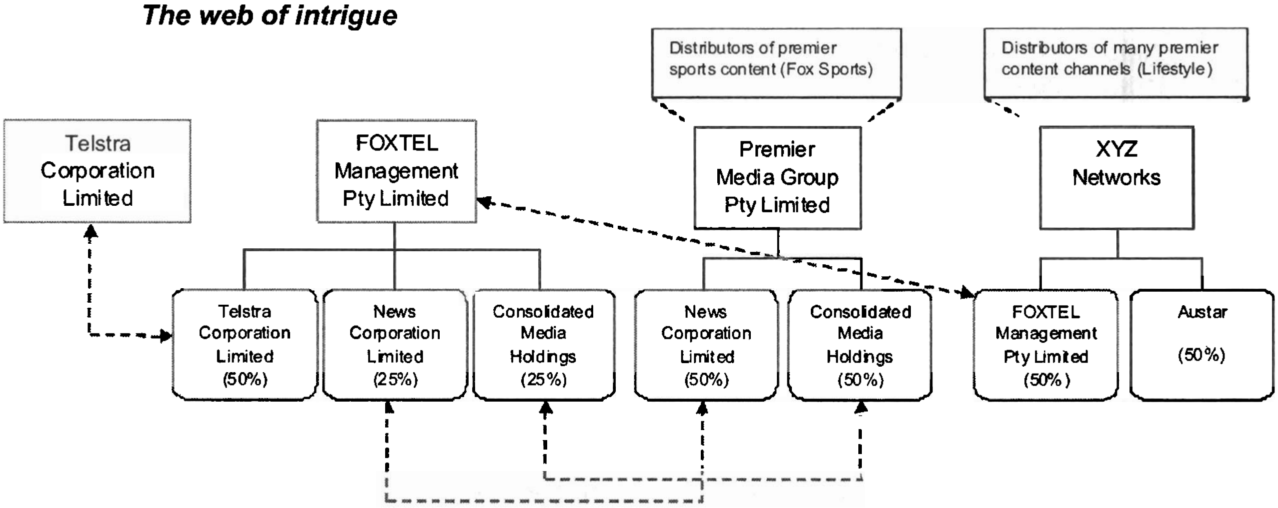
> *"At no time has Foxtel sought to prevent channels* ***that are not exclusive to Foxtel*** *(of which there are many) from entering into an agreement with TransACT.* **[emphasis added]**
>
> *Foxtel therefore denies that either of its agreements with Premier Media Group or PMP are likely to result in a substantial lessening of competition in any relevant market in Australia."*

The most intriguing issue surrounding content in Australia is the web of dominant market power that has been create and allowed to grow between Foxtel, Telstra, the Network Distributors, such as Premier Media Group Pty Limited (PMG) and XYZ Networks Pty Limited (XYZ) and all their associated controlling entities.

As can be seen in the diagram on the next page, two of the major content distributors in Australia (PMG and XYZ) both have distinct ties through their controlling entities of News Corporation Limited (News Corp), Consolidated Media Holdings Limited (CMH) and Foxtel respectively. News Corp and CMH not only share a Joint Venture (JV) partnership in PMG but they also have a combined 50% shareholding in Foxtel.

This is where Telstra steps into the web. Through its market dominance in the fixed-line and cable networks and its horizontal integration and convergence into the media content market (via its 50% stake in Foxtel), together, Telstra and Foxtel effectively control much of the premium content in Australia.

The web of intrigue



Another prominent distributor of premium content is Premium Movie Partnership (PMP). PMP is an Australian registered partnership with its head office located at The Entertainment Quarter in Sydney. Established in 1995, PMP is jointly owned by 20th Century Fox, NBC Universal, Paramount Pictures, Sony Pictures and Liberty Media. Foxtel and PMP also have exclusive content arrangements established.

Were TransACT to be provided the same opportunity and given equivalence of access to the same premium content as Foxtel, then exclusive dealing notifications of this nature become less of an issue. Gaining equivalence of access to the same premium content as Foxtel, would allow TransACT to at least compete on a more level playing field, providing consumers with choice based on price, quality and service for all products, including broadband, and not just control of content.

This notification goes directly to the heart of section 46 of the *TPA*, whereby together, Foxtel and Telstra are misusing their combined market power and are forcing consumers to utilise a Telstra broadband service if they wish to acquire the Foxtel *Proposed Service.*

The Regulatory Framework

It has been well publicised that the incentives to engage in such anti-competitive conduct have been created by regulatory frameworks that have allowed Telstra to become the most integrated and powerful communications company in the world.

We have seen recently, in conjunction with the Rudd Government's announcement on 7 April 2009 to invest up to $43 billion over 8 years to build and operate a new super fast National Broadband Network[10], that one of their 'plans of action' was to commence a consultative process on necessary changes to the existing telecommunications regulatory regime. The introduction of the *Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2009* (*CCS Bill 2009*) into the Parliament represents a significant part of that action plan.

[10] http://www.minister.dbcde.gov.au/media/media_releases/2009/022

In the Government's *CCS Bill 2009* 'Explanatory Memorandum' (Memorandum) there is explicit comment on both Telstra's vertical and horizontal integration in today's market.

The Memorandum states that:

> *"Compared to most other countries, Telstra's level of integration is unique. For example, in most other developed countries there are restrictions on incumbents from owning both cable and traditional fixed-line telephone networks. Unlike Australia, in a range of countries, the fixed-line incumbent does not also own the largest mobile carrier as measured by market share."*[11]

The Memorandum continues to say that:

> *"In addition to Telstra's control of fixed line networks, Telstra's 50 per cent stake in Foxtel has hindered competition in both the telecommunications and pay-TV markets. This is because Telstra has the incentive to base its decisions on its interests in both the telecommunications market and its pay-TV interests. As a result, new products that a pure media company or a pure telecommunication wholesaler might offer are potentially not being made available to consumers."* [12]

When stated why Government action is needed, the Memorandum says:

> *"To ensure that competition across telecommunications platforms can prosper into the future, Telstra will be required to structurally separate, divest its cable network and Foxtel interests in order to acquire spectrum for advanced wireless broadband. However, under the legislation, the Minister has the power to exempt Telstra from requirements to divest its cable and pay-tv assets.*
>
> *These measures are designed to promote competition across the various telecommunications platforms, but provide Telstra will the flexibility to choose its future path."*[13]

The Memorandum further discusses details surrounding Telstra's ownership of Foxtel where it states that:

> *"The impacts and distortions in the development of the respective markets are difficult to quantify, however, problems arise because content can provide telecommunications service providers with new high-value business opportunities and further stimulates demand for their carriage services. Exclusive access to content creates an effective means of locking customers*

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[11] *Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2009*, Explanatory Memorandum, p.35
[12] *Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2009*, Explanatory Memorandum, p.35-36
[13] *Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2009*, Explanatory Memorandum, p.36

in. Further lock-in can be achieved through the bundling of services (i.e. selling two or more types of services together at a discount rate). Access to content on an exclusive basis limits the opportunities available to competitors, in both the carriage and content sectors."[14]

Optus, in their submission on Regulatory Reform for 21st Century Broadband, contends that Telstra's investment in Foxtel represents a significant threat to competition:

> "*Telstra's fifty per cent ownership in Foxtel has been recognised to have caused significant distortions in the development of the Pay TV market within Australia, with associated impacts on the telecommunications fixed line services market.*"—Optus[15]

Optus hits the nail on the head, in relation to this notification, where it notes the associated impacts on the telecommunications fixed-line services market. It is precisely the fixed-line broadband market, where this notification if approved, would actually endorsed anti-competitive conduct and 'third line forcing' when the benefits clearly do not outweigh the detriment to the public.

Additionally, a number of other submitters to the Regulatory Reform for 21st Century Broadband Discussion Paper, including TransACT, indicated that Telstra should be required to divest its Foxtel interests:

> "*...Telstra should be required to immediately divest its interests in Foxtel.*" — Macquarie Telecom[16]
>
> "*...the Government ought to require Telstra to divest its ownership interest in FOXTEL.*" —Austar[17]
>
> "*TransACT would encourage the government to consider... horizontal separation, by requiring Telstra to divest its 50% interest in FOXTEL...*" — TransACT[18]
>
> "*Competition policies dictate that Telstra must be forced to divest its ownership interest in Foxtel.*" —Primus[19]
>
> "*The CCC submits Telstra should be required to divest itself of its interests in the HFC cable and Foxtel...*" —Competitive Carriers Coalition[20]

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[14] *Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2009,* Explanatory Memorandum, p.36-37

[15] Optus, *Optus Submission—Regulatory Reform for the 21st Century*, June 2009, p.61.

[16] Macquarie Telecom, *Submission in Response to National Broadband Network: Regulatory Reform for 21st Century Broadband Discussion Paper*, 3 June 2009, p.11.

[17] Austar United Communications Limited, *Response To National Broadband Network: Regulatory Reform for 21st Century Broadband*, 3 June 2009, p.11.

[18] TransACT Capital Communications Pty Ltd, *Submission on National Broadband Network: Regulatory Reform for 21st Century Broadband Discussion Paper*, 3 June 2009, p.36.

[19] Primus Telecom, *Submission in Response to National Broadband Network Regulatory Reform for 21st Century Broadband Discussion Paper*, 3 June 2009, p.2.

[20] Competitive Carriers Coalition, *Response to the Government Discussion Paper: National Broadband Network: Regulatory Reform for 21st Century Broadband Discussion Paper*, June 2009, p.12.

It is also interesting to note that in a speech at an Australian Telecommunications User Group (ATUG) Regional Conference, 21 May 2009, the ACCC's Chairman Mr Graeme Samuel also stated reasons why control of content could stifle competition:

> "*...a telecommunications network operator is able to acquire sufficient compelling content on an exclusive basis, such that it limits alternative network owners' ability to offer attractive packages to consumers.*"—Mr Graeme Samuel, ACCC[21]

The ACCC also recommended to the Government, as far back as June 2003, in its *Emerging Market Structures in the Communications Sector* report that it should consider legislating to require Telstra to divest both its HFC network and 50 per cent stake in Foxtel. The ACCC stated:

> *"The Commission believes substantial competition benefits would be derived from requiring Telstra to fully divest its HFC network and its 50 per cent shareholding in Foxtel. Divestiture of the HFC would introduce a new infrastructure competitor into the market, establishing conditions for increased rivalry and innovation in the supply of a full range of telecommunications services.* ***If Telstra were divested of its Foxtel shareholding, both Telstra and Foxtel would have improved incentives to supply their services to competitors and Telstra would have diminished ability to use its market power to leverage into converged markets."***[22] **[emphasis added]**

This was reiterated again by the ACCC in its June 2009 submission to the Department of Broadband and the Digital Economy (DBCDE) on *National Broadband Network: Regulatory Reform for 21st Century Broadband.*[23]

Austar in its submission also noted the ability of a dominant telecommunications operator to reinforce its dominance not just through subscription television services but also in the broadband market is an issue:

> "*The issue is the potential for a powerful telecommunications operator to exploit its power in the platform delivery market to close off content competition, not just in subscription television, but also in broadband service acquisition. We have already seen this in the exclusive content deal that Telstra did for AFL rights for its BigPond internet service. As the lines between platforms begin to blur as true "convergence" takes hold, the ability or a dominant telco operator to dominate this space and use content rights to reinforce that dominance become even more concerning.*"—Austar[24]

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[21] Mr Graeme Samuel, Australian Telecommunications User Group Regional Conference, 21 May 2009, p.9.
[22] ACCC, June 2003, Emerging markets in the Communications Sector report , p.57
[23] ACCC, June 2009, Submission on National Broadband Network: Regulatory Reform for 21st Century Broadband, F.6.1. Horizontal separation, p.158
[24] Austar United Communications Limited, *Response To National Broadband Network: Regulatory Reform for 21st Century Broadband*, 3 June 2009, p.10.

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In Conclusion

TransACT believes it is clearly evident by the number of recent public submissions, suggesting that Telstra's current (50%) stake in Foxtel is not in the best interests of competition, not only in Pay TV markets but also downstream broadband markets, that this latest notification by Foxtel is the type of anti-competitive conduct that was envisage. It is precisely the type of conduct that competitors, consumer groups and regulators, have been saying for years, required remedial action. This conduct is a real, present day example of the abject failure of Australia's telecommunications market and regulatory regime.

This aggressive misuse of market power to stifle competition and reduce consumer choice is the underlying focus and reason for the introduction and tabling of the *CCS Bill 2009* into Parliament. This is why competitors, consumer groups and the Rudd Government are strongly supporting the passage of this Bill, even the ACCC have provided their support for such needed regulatory reform.

TransACT implores the ACCC to seriously consider the full implications associated with this exclusive dealing notification N94674 and strongly recommends that the ACCC revoke this application in its current form.

Telstra and Foxtel must not be permitted to further entrench their market power and misuse that power, especially at such a critical time in the development of competitive broadband and content markets in Australia. Allowing this notification to stand would only endorse these types of anti-competitive conduct arrangements, thereby reducing competition and efficiency in business resulting in a poorer choice for consumers in price, quality and service.

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