



Telstra Corporation Limited
Public Policy and Communications

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Commission

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Dear Dr Chadwick,

Re: Exclusive dealing notification N94674 lodged by FOXTEL

Thank you for the opportunity to comment on the above mentioned notification.

We have reviewed the notification, the accompanying submission lodged by FOXTEL and FOXTEL's response dated 26 May 2010 to the queries raised by the Commission. In summary, Telstra's view is that the notified conduct will deliver public benefits and will result in no public detriment.

In this submission Telstra will first take the opportunity to provide commercial context regarding the Proposed Service that has been notified by FOXTEL. Telstra will thereafter comment on the relevant markets identified by FOXTEL in its notification, as well as other markets which the Commission may consider as relevant. Telstra will conclude with some observations in respect of the questions which the Commission put to FOXTEL in its letter of 19 May 2010.

1. Commercial context

Negotiation of the commercial arrangements for the Proposed Service was conducted at arm's length between FOXTEL and Telstra. While Telstra has a close working relationship with FOXTEL and an ownership interest in FOXTEL, Telstra has no influence or control over day-to-day commercial decision making by FOXTEL. For example, none of the management of FOXTEL is nominated by Telstra, and each FOXTEL shareholder has a right to veto transactions involving another shareholder.

The grant of exclusivity by FOXTEL in respect of access to the Proposed Service is a rational commercial decision, as it enables FOXTEL to provide the Proposed Service to subscribers on an unmetered basis, and at the same time largely avoid the cost of contributing to Telstra's data carriage charges that it would otherwise incur. Telstra's understanding from its negotiations with FOXTEL in respect of the Proposed Service, is that FOXTEL believes the appeal of the service depends on it being unmetered for subscribers, who would otherwise be reluctant to download films and television programs which consume large amounts of data download capacity due to concern about excess data charges. While downloads and uploads by FOXTEL subscribers will be unmetered irrespective of exclusivity, there is a cost

associated with this data carriage which must be covered. Telstra is prepared to absorb the majority of that data carriage cost in order to derive the benefit of differentiating its broadband service from the services provided by its ISP competitors.

FOXTEL subscribers benefit from this arrangement because they are provided with access to unmetered downloads of video-on-demand content, where absent exclusivity they are more likely to have to pay for the cost of data carriage in some way (for example, through higher cost per on-demand movie or television program access), as FOXTEL, for its part, would be required to pay greater carriage costs to Telstra.

If the FOXTEL video-on-demand service is provided non-exclusively, such that FOXTEL subscribers can make use of any ISP's broadband service to access the content, then there is no differentiation benefit derived by any ISP, and accordingly all ISPs would likely expect some contribution to their data carriage costs before agreeing to provide unmetered access.

Accordingly, the commercial drivers of the arrangements for the Proposed Service are:

- the market norm in Australia of broadband service providers applying download capacity limits and acceptable usage policies for subscribers, designed to enable ISPs to achieve a predictable data carriage cost base; and
- the need for broadband service providers to differentiate their services in order to retain subscribers by providing better value compared to ISPs that compete on price alone.

Importantly, no member of the public is ultimately disadvantaged by the Proposed Service. The content provided under the Proposed Service is predominantly non-exclusive. It is motion picture and television content owned by parties who do not ordinarily make their content available on an exclusive basis. It is not live sports content. Therefore, FOXTEL subscribers who cannot acquire the Proposed Service because they do not obtain their broadband service from Telstra, will be free to access the same content from multiple other sources, including DVD (rental or purchase) and the platforms for online video-on-demand services already available in the Australian market such as TiVo, and anticipated new entrants ranging from FetchTV to Google. In fact, even FOXTEL itself offers the "FOXTEL by Broadband" service with approximately 300 programs which subscribers may access via any broadband connection, and has recently announced a Microsoft Xbox-based service with linear channels and on-demand programming.¹

Last, the Proposed Service should be seen in the context of its scale and function. In respect of scale, the Proposed Service will only be available to FOXTEL direct subscribers who have an iQ set top unit, and of those subscribers, the estimated number whose broadband service is not currently supplied by Telstra is less than 6 percent of the total number of fixed-line broadband subscribers in Australia and is less than 4 percent of the total Australian audience for audiovisual entertainment.² Given such small proportions of the public, and that the relevant service is easily substitutable due to the non-exclusive nature of the content, it is unlikely that there could be any material impact on competition. Further, as explained below, not all of those FOXTEL subscribers will be interested in the Proposed Service and/or its substitutes.

¹ FOXTEL Press Release, "FOXTEL and Microsoft Sign Ground-breaking Xbox Agreement", 20 May 2010, www.foxtel.com.au/about-foxtel/communications/foxtel-and-microsoft-sign-ground-breaking-xbox-agreement-71310.htm

² These estimates use the total number of Australian television households as indicative of the market for the retail supply of audiovisual content. Data sources are the Australian Bureau of Statistics, OzTAM, the Telstra Annual Report for the year ended 2009, FOXTEL information in the public domain, and Telstra internal data estimating fixed broadband subscriber numbers.

Similarly, the function of the Proposed Service is modest: it is a complementary service for subscribers to one of the highest quality and most diverse subscription television offerings in the world, FOXTEL, which already includes Near Video on Demand (NVOD) capability through time-shifted movie channels, a cutting edge PVR in the form of the iQ set top unit (providing multiple viewing, storage and time-shifting functions) and catch-up TV via the "FOXTEL by Broadband" service. Subscribers to services such as TiVo and Telstra's own T-Box™, which went on sale in Australia yesterday,³ will usually be seeking to augment their access to the free-to-air digital channels, whereas users of the Proposed Service already enjoy the richness of FOXTEL subscription television, and hence the incremental value of the Proposed Service will be significantly lower than in the case of subscribers to competing online on-demand platforms, such as TiVo and T-Box™.

2. Relevant markets

In order to assess the public benefit or otherwise of the conduct, it is helpful to define the relevant markets in which the notified conduct may affect the intensity of competition. In section 3 of its notification FOXTEL suggested three relevant markets in respect of which this analysis should be conducted.

- the market for the retail supply of audiovisual content;
- the market for the acquisition of audiovisual content; and
- the market for the retail provision of broadband telecommunication services.

Telstra recognises that the definition of relevant markets is controversial and the Commission may consider markets defined more narrowly, for example a market for online content delivered over broadband. While Telstra does not concede that such a narrow market should properly be considered to exist for the purposes of competition assessment under applicable law, we will nonetheless additionally comment on whether there is any detriment to the public caused in such a market by the Proposed Service.

a. The market for the retail supply of audiovisual content

Telstra agrees with FOXTEL's description of the retail market for the supply of audiovisual content. While that market is somewhat distorted by regulatory protection of the free to air broadcasters (for example, via embargoes on the issue of new licences and the anti-siphoning regime), it is a highly competitive market characterised by numerous competing delivery platforms. As the FOXTEL submission indicates, there are a large number of existing and future participants in this market. Many of these participants are large, well resourced and very capable competitors.

The FOXTEL notification sets out an extensive list of current competitors and anticipated near-term entrants in the market for the retail supply of audiovisual content (see section 4.4 of the notification). This includes content available from Telstra BigPond and the Telstra T-Box™.

FOXTEL further supplemented this analysis with additional detail regarding TiVo, Sony, and ISP participants in the market, in its reply to Question 10 posed by the Commission (see page 4 of FOXTEL's reply of 26 May 2010).

Telstra does not propose to repeat the information already provided by FOXTEL. However, it is worth emphasising that competition in the market is increasing rapidly, both in terms of new platforms entering the market and existing services

³ Telstra media release, "Telstra's T-Box™ goes on sale as MGM Studios join BigPond TV®", 16 June 2010, www.telstra.com.au/abouttelstra/media-centre/announcements/telstras-t-box-goes-on-sale-as-mgm-studios-join-bigpond-tv.xml

expanding their channels for delivery. Just this week, a new video-on-demand service called "Juno Interactive" was announced, which will provide access to television programs and movies from major US and European content owners using the Adobe Flash application. Consumers will be able to access the Juno service using any ISP's broadband connection, by buying access to individual programs/movies subject to a time-restricted viewing window. A "beta" version will launch within the coming two months.⁴

b. The market for the retail supply of online audiovisual content

Telstra notes that the Commission Chairman in a recent address said:

*"Last month ISP iiNet announced it had teamed with content aggregator FetchTV to be the first in Australia to offer this IPTV service later this year. Telstra has announced its T-Box download and streaming service. These IPTV products will compete with existing internet enabled devices including Foxtel IQ; TiVo; and Sony's PlayTV accessory to the PlayStation 3 console. And for some time now a number of ISPs have been offering unmetered downloads of audio visual content, for example the ABC's iView. I note that senior management at Foxtel consider free-to-air channels on the digital platform as their serious competition, but I wonder if they should be glancing over their shoulder at the new entrants in the IPTV market as the potential challengers to Foxtel's dominance of Pay TV."*⁵

Telstra respectfully agrees with this comment, although Telstra does not believe there is currently a distinct "Pay TV" market in Australia. In Telstra's view, it is DVD suppliers and free-to-air broadcasters who should also be looking over their shoulders at the IPTV new entrants.

Given the competitive pressures on FOXTEL which the Chairman has outlined, it is unsurprising that FOXTEL has sought to provide to the market a competing online video-on-demand service additional to the already available "FOXTEL by Broadband" service and FOXTEL subscription broadcast services.

If a narrower market definition were adopted (for example, internet delivered audiovisual content), Telstra submits that the barriers to entry in this market are low, evidenced by the large number of existing or planned competitors, and therefore the proposed FOXTEL conduct would not result in any harm to competition in that market, particularly having regard to the adjunct nature of the Proposed Service, the non-exclusive nature of the content to be included, and the small proportion of the market by which it can be accessed.

To the extent that retail supply of online audiovisual content requires a set-top unit rather than (or in addition to) delivery via a personal computer, that requirement is not of itself a barrier to entry. Television receivers have for some time had multiple device input sockets / ports, so that several devices can be connected to the television receiver. Similarly, most broadband modems being supplied to consumers have multiple Ethernet ports and WiFi functionality, meaning that a consumer can connect multiple devices to his or her modem. Even the most basic consumer broadband modem can be connected to a low cost router to provide multiple ports

⁴ Renai LeMay, "Australia gets Flash web video on demand service", *IT Wire*, 15 June, see: www.itwire.com/it-industry-news/strategy/39774-australia-gets-flash-web-video-on-demand-service

⁵ Graeme Samuel, address to the Communications and Media Law Association, Sydney, 4 May 2010, www.accc.gov.au/content/item.phtml?itemId=926526&nodeId=e43a94f0a7945d6c75b8514d1d9a311d&fn=20100504_Samuel_CAMLA.pdf

and WiFi. The cost of set-top units to consumers in the Australian market at present, for example the TiVo box and the T-Box™, is barely more than the standalone cost of a digital television tuner device plus an external hard drive of similar capacity. There is no reason why consumers will not acquire two or more set-top units, in the same way that many consumers have multiple portable electronic devices (netbook, personal DVD player, smartphone, MP3 player, handheld gaming device, etc.).

c. The market for the acquisition of audiovisual content

FOXTEL's submission also notes that it competes against many market participants for the acquisition of audiovisual content. Telstra would also observe that DVD supply (whether for sale or rental) also competes for audiovisual content, and, in relation to premium movies, typically benefits from a release 'window' which is earlier than online download or free to air/subscription broadcast. It is also Telstra's experience that the major Hollywood studios will typically licence their content for online supply on a non-exclusive basis. Thus, studio content will typically be available to all online players, and the non-exclusive acquisition of content by FOXTEL cannot foreclose the acquisition of that content by other market participants.

The proliferation of delivery channels and the fragmentation of audiences increases the bargaining power of content rights owners relative to distribution channels and provides rights owners with the opportunity and incentive to enter into distribution agreements with as many channels to market as possible. Where a potential distributor is not of sufficient scale to warrant the transaction costs of entering into a distribution agreement, aggregators such as TiVo and FetchTV act to assemble a critical mass of distributors.

d. The market for the retail provision of broadband telecommunication services

Telstra agrees with FOXTEL's view that the retail market for broadband internet access is highly competitive; the level of competition may increase even further with the roll out of the proposed National Broadband Network. The most recently issued annual ACMA report on the industry found that, as of June 2009, there were an estimated 638 ISPs in operation.⁶ According to the Australian Bureau of Statistics, 37 of those ISPs have more than 10,000 active subscribers, and 62% of all households now have broadband.⁷ Take-up of unbundled local loop services grew 136.3% from September 2007 to September 2009, pointing to the speed and extent of migration to competitive broadband services. As FOXTEL's submission notes, many broadband internet access providers already provide bundled content/broadband offers.

Telstra's experience is that consumers choose their ISP on the basis of numerous factors. Price is a key consideration, and consumers will also consider the value obtained in the form of differentiated download capacity packages, the ISP's reputation for service and customer support, the term of the contract, access to additional features and services, etc.

⁶ ACMA Communications Report 2008-09, p27, www.acma.gov.au/WEB/STANDARD/1001/pc=PC_311972

⁷ ABS, "Nearly two-thirds of Australian households now have broadband", Media Release, 16 December 2009, www.abs.gov.au/ausstats/abs@.nsf/mediareleasesbytitle/180CCDDCB50AFA02CA257522001A3F4B?OpenDocument

Telstra has noted media comments made by Optus in response to the publication of the FOXTEL notification by the Commission.⁸ Telstra's view is that Optus has of its own election failed to innovate and differentiate its broadband services from its competitors in the Australian market, but instead competes predominantly on the basis of price. It is therefore unsurprising that, when faced with a competitor such as BigPond which is differentiating its services by offering additional features to subscribers such as unmetering of the Proposed Service, the reaction from Optus is to call on the Commission to prohibit the proposed innovation. Telstra's view is that, to the contrary, by allowing the Proposed Service to be supplied the Commission will be incentivising the development of competitive new broadband service features by other ISPs. The Proposed Service will be characterised predominantly by non-exclusive content which Optus and others are free to obtain for supply to their customers.

3. The Commission's questions to FOXTEL

While Telstra understands that FOXTEL has responded to the questions put by the Commission to FOXTEL in the Commission's letter of 19 May 2010, Telstra makes the following observations:

- In regard to Question 7, provided the arrangements make rational commercial sense (which they do), in Telstra's view it is not relevant to determination of the public benefit or otherwise of the Proposed Service whether or not FOXTEL approached other ISPs.
- In regard to Question 10, Telstra acknowledges the Commission's point that FetchTV has not yet launched in the market. However, iiNet is already promoting the service (see: www.iinet.net.au/fetchtv/), has announced its launch pricing, and has indicated that the service will be available by August 2010.⁹

4. Conclusion

In conclusion, given the highly competitive nature of all relevant markets, the proposed FOXTEL conduct cannot lessen competition, and indeed, will enhance competition. The benefit to competition will occur immediately by addition of a new broadband-delivered content service to the market; and over time by incentivising the development of competing services by Telstra's and FOXTEL's competitors. As explained, the barriers to duplication of provision of the content on the Proposed Service are low due to the predominantly non-exclusive nature of the content. Therefore, there is unlikely to be any public detriment caused by the Proposed Service, particularly in circumstances where consumers have myriad competing services for provision of audiovisual content available to them. Many consumers will elect to make use of more than one such service.

Telstra also agrees with FOXTEL's view in relation to the public benefits of the proposed FOXTEL service. The proposed FOXTEL service will deliver new services to consumers, with both convenience and ease of use. These new services provide the same experience as DVD rental/purchase, but with the added convenience of download direct to the set top unit (i.e. no trip to the video store required). The new service also provides content at a time selected by the consumer, unlike broadcast services where the consumer can watch only

⁸ Lucy Battersby, "Telstra accused of leveraging", *Sydney Morning Herald*, 4 June 2010, available at: <http://www.smh.com.au/business/telstra-accused-of-leveraging-20100603-x6zl.html>

⁹ See Petroc Wilton, "iiNet reveals IPTV pricing", *Communications Day*, 15 June 2010, at 4; see also Jenna Pitcher, "iiNet unveils IPTV pricing", *Delimiter*, 12 June 2010, at <http://delimiter.com.au/2010/06/12/iinet-unveils-iptv-pricing/>

what the broadcaster decides to broadcast and at a time decided by the broadcaster (unless a PVR is used to time shift viewing).

Please let me know if I can be of further assistance.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Jane van Beelen", with a stylized flourish at the end.

Jane van Beelen
Executive Director – Regulatory Affairs
Public Policy & Communications