Forum

Competition, broadcasting and pay TV

Following is an edited text of a speech by Commissioner Ross Jones to the Australian Broadcasting summit, Sydney, February 2003.

The points Commissioner Jones covered in his speech included the sections of the Trade Practices Act that impinge on media and broadcasting and the role of the Commission; the characteristics of broadcasting in Australia (foreign ownership and cross-media ownership); pay TV and also the thinking that underpinned the Commission's acceptance of undertakings given by Foxtel and Optus last year.

Commissioner Jones then described the provisions of the TPA and the Commission's role in enforcing it.

Broadcasting and broadcasting regulation in Australia

Notwithstanding the often cited but rarely explained concept of convergence, the technical characteristics of all media are not identical. This means that the content—in the form of entertainment or information, and advertising—can never be the same.

Radio news, for example, is not television news, and, an article in *New Idea* is not the same as an opinion piece in *The Australian*.

For this reason, the degree of substitutability between content in various media markets—magazines, newspaper, radio and television—is generally considered to be slight. That is, media markets can largely be considered to be separate and distinct.

Broadcasting exists as a separate and distinct market.

It has been a truism of Australian broadcasting that barriers to entry are high. Within UHF and VHF bands reserved for television broadcasting, it has been generally accepted that there was only sufficient capacity in most areas for six wide-area channels.

In addition, broadcasting is characterised by economies of scale and scope. That is, cost advantages accrue to firms as a result of large production runs (because per unit costs are reduced), and accrue to firms that employ a single facility to produce a diverse range of goods and services.

These factors increase the probability that the market tends towards concentration.

That said, the shape of Australia's broadcasting industry has not just been defined by the technical characteristics of markets, the availability or otherwise of spectrum and the commercial competence of broadcasters. The industry is heavily regulated, and this regulation has acted to stymie the operation of the market.

Thus, despite 'room' being available for one more channel in capital cities, and despite several proposals for a sixth channel, such capacity has only ever been filled on a temporary basis by community broadcasters.

The grounds for rejecting a fourth commercial licence are sometimes presented as a desire to ensure viability, which in this context is not the viability of a broadcasting market, or the viability of Australian content, but the viability of incumbent commercial licensees. Indeed, until the *Broadcasting Services Act 1992* was enacted, viability was a licence criterion, and had been used to restrict entry. As a consequence there has been no significant new free-to-air entry in capital city markets since the mid-1960s.

Most recently, the banning of a new commercial television network to facilitate investment in digital technology by incumbent broadcasters has come at the cost of increased competition.

Clearly, regulation has reduced competition. A high level of protection is provided to the incumbent broadcasters in the radio and free-to-air television markets. The prices that potential entrants are prepared to pay is evidence that protection from competition can create a relatively easy and profitable life.

As a competition regulator, I find it peculiar that many firms in the broadcasting industry are given a level of protection from failure that is not given to firms in other industries. The overwhelming majority of Australian firms are subject to the rigours of the marketplace. Governments have reduced regulatory barriers and protection that was once endemic in Australian industry and the results have been beneficial to economic growth.

Broadcasting has been a major exception in market liberalisation.

Any legislation that restricts competition should be retained only if the benefits to the community as a whole outweigh the cost, and if the policy objectives can only be met through restricting competition.

The regulatory environment should be competitively neutral. That is, regulations should apply equally to all competitors. The convergence of different sectors —in particular, electronic media with telecommunications—means that the principle of competitive neutrality becomes increasingly important. I note that there are significant and important differences in the way licences are provided. For example, free-to-air television stations do not have to bid for spectrum, whereas some forms of pay TV and GSM mobile telecommunications service operators must make payment for their licences.

In this context, spectrum should be allocated as efficiently as possible. There should be mechanisms to achieve this, such as, in the absence of distortions, a process of auction. In doing so, there is need to ensure that spectrum is not hoarded or allocated to purposes that are being superseded by new technologies.

I want now to turn from the management of spectrum to the regulation of content.

Traditionally broadcasting was radio based and relied entirely on advertising support. Some people have argued that these two features have provided the justification for much of the regulatory structure that has developed around the industry. Being radio based, broadcasting operated with a fixed and often limited amount of spectrum. It was unencoded, given the high cost of encryption/decryption. Consequently it was not possible to exclude consumers from receiving the signal and therefore it could not charge consumers directly for the programs that were broadcast.

The consequences of this were that broadcasting had to develop its own revenue model. It had to be funded by advertising or by direct subsidies from the government or some combination of both. Given the limited number of available channels, it is not unreasonable to expect that the competition between this small number of competitors would not necessarily maximise consumer welfare. Putting it simply, if there are only a small number of broadcasters, they are likely to each try to maximise their advertising revenue by maximising audience. In a small market, this is likely to lead to broadcasters providing similar programming to cater to the mass market and offering similar programming at similar times.

These types of arguments have been used to support a significant amount of regulation of broadcasting such as licensing requirements, regulatory rules regarding content, and subsidies to certain types of broadcasters and certain types of broadcasting content.

This regulation may explicitly or implicitly restrict competition. Australia has explicitly limited the number of free-to-air broadcasters to a greater extent than justified by spectrum scarcity. A few years ago proposals for the 'sixth channel' which would have allowed the entry of another free-to-air commercial channel were dropped and more recently the moratorium on new free-to-air entry has been extended to December 2006. Australia also prevented the development of alternative business models such as subscription television until 1995, further limiting competition and consumer choice.

Such regulatory restrictions on competition in broadcasting have had a significant effect on the profitability of the incumbent broadcasters and the quality of the programs. Regulatory restrictions on the number of broadcasters typically lead to regulations on the quantity and location of advertising which can be shown. In Australia, there are therefore limits on the number of advertisements per hour and limits on the types of advertising that is allowed in certain time periods. This is an example of how regulation of one element, in this case, entry, leads to the need for further regulatory intervention.

The restrictions on new entry in free-to-air improves the profitability of the incumbents but comes with an obligation. The free-to-air commercial networks are required to show a certain proportion of Australian programming. This programming is typically more expensive than comparable foreign programming. The restrictions on competition by limiting entry supposedly provide the profits for the free-to-air networks to fund this expensive Australian programming.

One important issue I touched on previously is that the regulations must be efficient. That is their cost

should not be greater than the benefits derived. One unfortunate element of the current system is that it is difficult to calculate the costs and benefits of the arrangement. The costs of the system are hidden in a maze of transfers, both internal and external. For example, there is the cost to consumers in terms of the reduced choice in programming because of the entry restrictions. In return they get more Australian programming than may otherwise be the case. But what of the effect on the free-to-air networks? They subsidise the Australian content requirements from their profits. It is extremely difficult to estimate whether the benefit derived from the protection from competition is equal to the amount that they transfer into local production. Given the prices at which television stations have sold in Australia, it is not unreasonable to suggest that there have been very lucrative profits made in free-to-air broadcasting from the restrictions on entry.

So while it may be possible to argue that some form of regulation of programming on free-to-air television may be justified, the method by which the objectives of increased local content are being met, may not be the most efficient.

I might briefly comment on the nature of the content regulation on Australian TV. Commercial television stations are required to broadcast Australian programs for at least 55 per cent of the total transmission time between 6 am and midnight, as well as comply with sub-quotas for the transmission of minimum quantities of first release adult drama and documentaries. There are also quotas for the transmission of children's programs generally as well as specific requirements for first release and repeat children's drama.

Quotas are generally a very inefficient and distorting mechanism to provide protection. The effects of this regulatory regime are difficult to quantify. There is only one serious study that I am aware of that attempted to do this. Franco Papandreo of the University of Canberra in a seminal economics study conducted an extensive cost-benefit analysis of Australian content regulation in the mid-1990s. That study accepted the argument that domestic content regulation satisfied the necessary preconditions for intervention, namely the existence of market failure and some improvement in benefit to the society from the intervention.

However, it also found that the regulatory mechanisms used were not efficient. It found that the transmission quota contributed the least to the objectives of the regulation. The recent Productivity Commission inquiry into broadcasting reached similar conclusions indicating that it did not think that the transmission quota was meeting its social and cultural objectives.

One conclusion from these studies is that the achievement of a high amount of Australian content i.e. over 55 per cent in aggregate would have occurred anyway in an unregulated market, but it seems less likely that the drama and the children's quotas would have been achieved.

Can broadcasting markets themselves be made more competitive?

One possible response would be to ease foreign ownership restrictions.

One objective of the Broadcasting Services Act is to ensure that Australians have effective control of the more influential broadcasting services. Among other things, the Act provides that a person is restricted from controlling a commercial television licence and from having company interests that exceed 15 per cent.

There are no foreign ownership limits in radio.

In pay TV foreign persons are restricted to 20 per cent of any single pay TV licence, and to 35 per cent in aggregate of pay TV broadcasting licences.

To a reasoned observer, these limits would seem to be both arbitrary and avoidable.

In addition to foreign ownership regulation under the Broadcasting Act, foreign ownership is also indirectly regulated under the *Foreign Acquisitions and Takeovers Act 1975*. The Treasurer is given a discretionary power to approve foreign ownership proposals.

The view of the Commission is that these regulations may have the effect of reducing competition and that as competition is reduced, so are the prospects of enhanced efficiency, and possibly of greater plurality and diversity.

Implicit in the legislative objective that Australians have effective control of the more influential broadcasting services is the belief that a foreign-owned media outlet may have undue (negative) influence on public opinion.

Of course, this argument could be turned around to argue the case for foreign-owned media. It may be that a domestically-owned media outlet may have undue (negative) influence on public opinion and additional, foreign competition may provide greater plurality.

There is a linkage between foreign ownership and ownership across various forms of media.

The Commission has generally considered that for the purposes of competition analysis, print, magazines, radio and television have constituted separate markets. In its recent analysis of the Foxtel/Optus content supply agreement the Commission took the view that subscription television was in a separate market to free-to-air TV.

A consequence of such market definition is that in the absence of cross-media ownership rules, a number of possible mergers between firms in different media markets would not be in breach of Australian competition law.

It has sometimes been suggested that media markets should be defined more broadly. For example, given that all forms of media are a source of information, entertainment and opinion perhaps there is a broader market that encompasses these attributes. While this may be the case, from the perspective of a competition agency, such a broad market definition may not address market power issues. It may also be inconsistent with general community objectives of diversity of information and opinion.

It is extremely difficult to define the market and boundaries of a market for ideas and information. For example, the UK Government considered defining media markets via the share of voice approach whereby the consumption of different forms of media was weighted according to perceived influence. The setting of the weights would be a very contentious issue and one not generally associated with a competition agency.

Such an approach would also, of necessity, be additional to the standard merger analysis undertaken by the Commission and not a replacement. For example, under a very broad media market definition, it might even be possible that the merger of two newspaper companies or two television networks would not breach the Trade Practices Act.

Should cross-media restrictions be abolished it is possible that media-specific amendments could be made to the Trade Practices Act to introduce an additional public interest test which took account of plurality diversity and other social and political factors.

Convergence and pay TV

Convergence and pay TV have had, and will continue to have, an effect on the operation and programming of broadcasters.

It is not an easy business—there exist significant barriers to entry and expansion, particularly for smaller pay TV operators. It has to be said that even large operators are not immune from the pressures of cost and from the need to generate revenue in a market that exhibits a rate of penetration that is still low by OECD standards.

Establishing a network capable of delivering pay TV services involves sunk costs—there is considerable cost associated with acquiring satellite capacity or rolling out a cable network.

As sunk costs cannot be recovered if the market is abandoned, the risk of entry is increased. Clearly, if pay TV operators are to be viable, they need to achieve scale and expand revenue streams from multiple products.

New infrastructure networks are typically established with three broad streams of revenues in mind—telephony, pay TV and other broadband services. Failure to achieve these economies of scope, particularly the pay TV revenues streams, may create a vicious cycle that may make the network financially unviable.

Access regulation can provide for mandated use of pay TV distribution networks, or access on terms and conditions which promote competition and efficient use and investment in infrastructure. However, access regulation does not appear to have significantly altered the incentives to commercially negotiate, and otherwise to have limited effect in pay TV.

In particular, the Commission deemed broadcasting access services to be declared in 1997, and subsequently declared the analogue-specific subscription television broadband carriage service after concluding that it would promote the long-term interests of end-users. Following declaration, the Commission was notified of two disputes, by TARBS and C7 for access of the Telstra/Foxtel network. In 2001 the Commission released an interim determination. However, a number of technical issues associated with access are yet to be resolved and the arbitrations remain outstanding.

Importantly, capacity constraints on the existing analogue HFC cable networks have also constrained opportunities for access seekers, which will be greater when the HFC network is digitised.

Turning now to the question of content, the inability of potential operators to have access to necessary programming can create a barrier to entry.

Exclusive content/channel arrangements that exist for key programming in the upstream markets and

the existence of few suppliers of programming mean this barrier is a significant and real issue. There are only two suppliers of recent release movies (PMP and the Movie Network), and following the demise of C7 there is now only one significant supplier of premium sport (Fox Sports).

Access to quality content appears to be critical, with access to premium content important in terms of driving a high volume pay TV business—the premium content comprises recent release movies and premium local sport.

The Commission has previously indicated concern about exclusive contracting in pay TV in its submission to the Besley inquiry and the Productivity Commission's inquiry into telecommunications. Our specific concern was that lack of access to premium pay TV content was preventing the efficient deployment of broadband infrastructure, particularly in regional areas.

Premium content attracts subscribers. Content suppliers, seeking to maximum their revenues, will often look to distribute their product as widely as possible. However, the pay TV operator with the largest subscriber base, might be in a position to insist on exclusivity—such that the content supplier would not be allowed to offer the content to another operator. Exclusivity attracts subscribers, which in turn provides the ability to seek more exclusive content agreements. In these circumstances, smaller pay TV operators find it difficult to enter and survive in the market.

The competitive effects of this extend beyond pay TV markets. Infrastructure used for the delivery of pay TV can also be used to provide telephony and broadband services.

In the view of the Commission, in some circumstances these observed market behaviours and conditions may raise competition concerns.

Regulatory barriers to entry for pay TV operators are considerably lower than for the free-to-air sector, particularly as the number of licences is not restricted. However, it is subject to some important regulation which is likely to affect entry and expansion decisions.

In particular, pay TV operators are subject to the following restrictions:

- The *Broadcasting Services Amendment Act (No.3) 1999* enforced the requirement that pay TV drama services devote 10 per cent of total program expenditure to new Australian (or New Zealand) drama programs.
- Anti-siphoning rules restrict the broadcasting activities of pay TV operators. The *Broadcasting Services Act 1992* empowers the minister to list certain sporting events that should be televised free to the public, known as the anti-siphoning list. Licence conditions prevent pay TV operators from obtaining exclusive rights to televise listed events.
- The *Broadcasting Services Act 1992* also stipulated that, after 1 July 1997, subscription revenue must be the predominant source of revenue for pay TV services. In other words, advertising revenue must not exceed subscription revenue.

These regulatory factors may affect the decisions of firms to enter the industry, or to expand offerings. For example, the local content quota may result in pay TV operators not expanding channel line-ups for the purpose of avoiding expenditure requirements.

Furthermore, while premium content acts to increase penetration, the anti-siphoning rules prevent pay TV operators from securing exclusive rights to key sports content which may retard the growth of subscription and revenue. These rules may deter firms from entering the industry.

Foxtel and Optus

As a final point on the matter of pay TV, I want to explain the Commission's decision on Foxtel and Optus.

The Commission last year accepted court enforceable undertakings proposed by Foxtel, Optus, Telstra and Austar to address the potential anti-competitive effects of the planned pay TV arrangements.

These arrangements allow Optus and Foxtel to share pay TV programming.

The undertakings provide access to programs for pay TV operators, broader choice for consumers and access to Telstra's cable network and Foxtel's set-top boxes.

The decision follows extensive consultations between the Commission and the industry since June, when we concluded the proposed arrangements were likely to have the effect of substantially lessening competition in a number of pay TV markets.

Pay TV operators will now have access to a more comprehensive range of programming, enabling them to offer pay TV consumers a broader range of programs, including popular movies and sports.

Most of the concerns originally raised about the arrangements related to the ability of Foxtel to prevent meaningful competition in the pay TV industry by blocking competitors from using either its programming or its cable network.

To address these questions, Foxtel and Austar have agreed to allow rival operators, such as TransACT and Neighbourhood Cable, to buy pay TV content.

Concerns about access to infrastructure, such as Telstra's cable network and Foxtel's set-top boxes, have been addressed by Foxtel and Telstra's undertakings to allow rival pay TV operators to use their analogue and proposed digital networks to provide competing pay TV services to consumers.

The Commission is currently considering the terms and conditions that Telstra and Foxtel intend to impose for access to these networks. We will determine whether or not they comply with the telecommunications access requirements of the *Trade Practices Act 1974*. The Commission expects to publish a final assessment of these terms and conditions by mid-2003.

Foxtel and Telstra have committed to digitise the pay TV network. This commitment was conditional upon the passing of the Telecommunications Competition Bill, which allows potential investors to seek an exemption from the access regime which would otherwise apply if the services were regulated in the future. This legislation was assented to in December last year.

The commitment was also conditional upon Foxtel and Telstra receiving exemption orders under this legislation and that if conditions are attached to these orders, that they are acceptable to Foxtel and Telstra acting reasonably.

In this matter, the Commission's role was to decide whether or not the undertakings addressed the potential anti-competitive conduct or effects arising directly from the content-sharing arrangements.

There was evidence that the competitive position of Optus in the market was being adversely affected by its inability to access and supply key content to its customers.

The content-sharing arrangements should enable Optus to improve its programming and ensure consumers are offered a better quality pay TV service.

That said, we will continue to monitor the pay TV and related industries closely. We will take immediate action if parties fail to comply with the spirit of the undertakings.

There is one other element associated with the Foxtel/Optus arrangements that I would like to mention. In March 2002 Senator Alston, Minister for Communications, Information Technology and the Arts, requested advice from the Commission on the extent to which emerging market structures arising out of the pay TV arrangements might affect competition in the broadcasting and communications sectors.

As everyone in this room would acknowledge, this is a complex task. A large number of interconnected elements are relevant to such analysis. The Commission consulted very widely with market participants during the analysis of the Foxtel/Optus arrangements and the related Foxtel/Telstra bundling notification. The report will address a number of matters including the nature of competition in pay TV, the relationship between telecommunications, free-to-air and pay TV sectors, access to content, current regulation of pay TV, free-to-air broadcasting and the bundling of communications, information and entertainment products.

The Commission expects to provide this report to the minister in a few weeks.

Conclusion

Australian broadcasting faces interesting times. Technological change will continue apace. This will place new demands on industry, on legislators and on regulators.

For the Commission's part, we will continue to apply the law. We acknowledge that the current regulatory regime as it applies to broadcasting is not without cost and could be improved, but feel that debate about the way forward is a matter for policymakers and not the enforcement agency.