SENATE ENVIRONMENT, COMMUNICATIONS, INFORMATION TECHNOLOGY AND THE ARTS LEGISLATION COMMITTEE

INQUIRY INTO TELECOMMUNICATIONS COMPETITION BILL 2002

SEVEN NETWORK SUPPLEMENTARY SUBMISSION

21 OCTOBER 2002

Telecommunications Competition Bill 2002
Supplementary Submission by Seven Network Limited

Executive Summary

- This submission supplements the points made in Seven's earlier submission to the Senate Enivronment, Communications, Information Technology and the Arts Committee.
- Provisions enacting exemptions from Part XIC of the Trade Practices Act should not be considered in advance of the ACCC's decision in relation to the Foxtel/Optus deal.
- The Part XIC access framework does not operate as intended. Amendments to Part XIC are required to:
  - provide a legislative guarantee of immediate access to digital pay TV
  - ensure that the access obligation is technology-neutral in terms of the delivery platform (eg cable, satellite etc)
  - ensure that the access obligations apply to any party that is involved in the pay TV supply chain
  - guarantee access to digital STUs and associated systems and services
  - ensure that access is provided on both a wholesale and retail basis, with access seekers being able to elect which form of access they require
  - ensure there are no technical impediments to immediate access, and
  - ensure that any pricing certainty applies only to future investments and not to the broadband cable itself.
- Seven supports the proposal to address the anti-competitive effects of the high level of vertical integration of Telstra's wholesale and retail services. However, accounting separation is insufficient. Structural reform is required. Accounting separation has been demonstrated to be ineffective overseas, particularly in the European Union. The worldwide trend is to mandate structural separation of incumbent telecommunications operators, requiring separation of their wholesale and retails arms, as well as separation of their infrastructure arms from their content provider arms. Such mandated structural separation should also apply to all infrastructure providers such as Foxtel, and not just Telstra.

Introduction

Seven Network Limited (Seven) made an initial submission in relation to the *Telecommunications Competition Bill 2002* (the Bill) on 15 October 2002.

That submission stated that there were a number of deficiencies in the existing access framework established under Part XIC of the *Trade Practices Act* that should be rectified before any proposal to enact exemptions or undertakings in relation to future services is considered.

This supplementary submission outlines in greater detail the deficiencies in the Part XIC regime and the steps necessary to rectify them.

This supplementary submission also contains additional comments in relation to the proposed accounting separation provisions to apply to Telstra.

1 Deficiencies in the Operation of Part XIC of the Trade Practices Act 1974

Seven's earlier submission to the Committee in relation to the provisions of Part 11 of the Bill enacting exemptions from standard access obligations and special access undertakings argued that an effective legislative framework was necessary to:

- guarantee immediate access to digital pay TV, and correct deficiencies in the current legislative mechanisms of the access regime;
- ensure there are no technical impediments to immediate access to the digitised network; and
- provide specific principles to be followed by the ACCC in relation to pricing.

The Exemption provisions contained in Items 60 and 62 of the Bill are those specifically demanded by Foxtel in its proposed undertakings to the ACCC in relation to the consideration of the deal between Foxtel, Optus and Telstra.

Clause 5 of those Undertakings promises to digitise the Telstra/Foxtel network. That undertaking is conditional on the passage of legislation that would enable an exemption of the network from the provisions of the Part XIC access regime and conditional on that exemption being granted.

The provisions of Part 11 of the Bill are therefore proposed to implement this requirement of Foxtel. As argued in Seven's earlier submission to the Commission, the digital pay television network is of such importance that it should never be exempted from the operation of Part XIC.

Further, there are alternative means to address the need for investment certainty for future services, such as a legislative declaration of those future services. This would ensure that the interests of access seekers were properly protected and would allow for undertakings to be given to deliver pricing certainty.

In Seven's view, the Committee should recommend the deletion of Parts 11 and 12 of the Bill until such time as the ACCC has made a final decision on the proposed Foxtel/Optus/Telstra deal. In any event, the Committee should recommend that exemption provisions such as those proposed in the Bill are not suitable for future

pay television digital infrastructure and services for the reasons given in Seven's earlier submission.

Further, the Committee should recommend the rectification of the current access regime in Part XIC which would then apply to future services. The specific matters that need to be addressed to deliver a workable access regime are discussed in the following paragraphs 1.1 – 1.13:

1.1 Current policy has the right focus

The original policy objectives for the current pay TV access regime were intended to achieve:

- 'open access' to pay TV infrastructure;
- 'end-to-end' access from the service provider to the consumer, covering all necessary elements of the pay TV service supply chain including set top boxes; and
- a competitive environment in the provision of pay TV services in Australia.

Seven strongly supports these policy objectives and believes they are still equally relevant in the current pay television sector, if not more so. An integral element of that policy has always been that the access regime be technology neutral. The open access regime which currently exists in the TPA was never expressed to be limited to analogue pay television, but rather was intended to apply to all services on the broadband cable, including digital services. **Annexure 1** contains more detail on the policy of technology neutrality.

The proposed amendments at Items 60 and 62 (and related Items) should not be allowed to circumvent this long-standing policy objective.

The current legislative provisions in Part XIC already provide a mechanism to achieve infrastructure investment certainty (section 152BS undertakings). These provisions are discussed in more detail in **Annexure 3.** Seven may not be opposed in principle to the introduction of measures intended to streamline these processes to allow the ACCC to consider pricing certainty prior to declaration of the completed investment, but only on the basis that the new framework delivers an equitable outcome for access seekers as well as access providers.

1.2 Undertakings

Undertakings under the current provisions of Part XIC are not sufficient to achieve third party access or effective competition to Telstra/Foxtel for the following reasons:

- because of the limitations of the Part XIC regime discussed below, the proposed section 152BS undertakings would not guarantee effective access to all the elements required to provide a pay television service to end users;
- as the Part XIC access regime is a *retail* model, the proposed undertaking would not require a pay television provider to include access seekers' channels in their pay TV package, provision of subscriber management services or inclusion in the electronic program guide (EPG). Access seekers do not have the option of obtaining access on a *wholesale* basis thereby avoiding the need to pay for costly duplication of customer management systems;
- the process of access undertakings allows a considerable period after digitisation before access seekers would be legally entitled to access. This is due in part to the requirement for public consultation periods on the proposed

undertakings and exemptions. Further delays arise as a result of the need to settle technical compliance, as well as the requirement to obtain third party consents in relation to the use of subscriber equipment and the IP associated with that equipment network facilities.

For these reasons, it is necessary for there to be further legislative amendments to rectify the limitations of the current access regime, and to put in place a legislative guarantee of immediate access to the digital pay television platforms and the digital pay TV services provided over them. Details of the necessary amendments proposed are outlined in section 4 below.

1.3 Further amendments required to Part XIC

Part XIC does not fully achieve the policy objectives of the access regime in relation to access to pay TV. Therefore, further amendments, in addition to the amendments at Item 95 (and associated Items), are required to the pay TV access regime to:

- provide a legislative guarantee of immediate access to digital pay TV, and correct deficiencies in the current legislative mechanisms of the access regime;
- ensure there are no technical impediments to immediate access to the digitised network; and
- provide pricing certainty for access providers and access seekers in relation to access to the digitised network.

Amendments to the legislative mechanisms are necessary to:

- guarantee access to digital STUs and associated systems (including SMS and CAS);
- apply the access obligations to any party who is involved in the supply chain for providing pay TV services to customers; and
- ensure that access is provided on both a retail and wholesale basis, with access seekers being able to elect which form of access they require.

To the extent that the amendments at Item 95 are intended to encourage investment in the digitisation of the Telstra/Foxtel network, in addition to the above suggested changes, further amendments are required which:

- provide a legislative guarantee of immediate access to the digitised pay TV service for access seekers;
- require that the implementation of the digital conditional access system be designed in such a way that facilitates ready access without the need for extensive technical modifications; and
- be neutral in terms of the delivery platform (eg cable, satellite etc) in relation to which the access obligations apply (in this context, it is relevant to note that the Telstra/Foxtel undertakings only offer a limited distribution mechanism for pay TV, namely the Telstra HFC cable, whereas two thirds of pay TV households receive their pay TV services via distribution mechanisms not covered by the section 87B undertakings).

Also, to the extent that any special amendments address pricing certainty, those amendments should:

- apply to future investments only and not apply to the broadband cable itself; and

- specify a simple formula or other clear mechanism that allows the financial terms of access to be known to both the access provider and access seekers, without any matters being left to the discretion of the access provider.

1.4 Access to STUs and ancillary services must be guaranteed

It is clear that government policy and the legislative intent of the current access regime is, and has consistently been, that set top units (STUs) and any other services to enable an access seeker to provide carriage or content services such as conditional access (CAS) and subscriber management systems (SMS) should be subject to the Part XIC access regime. **Annexure 2** gives further detail on the policy intention of Part XIC.

However, Seven's experience in attempting to gain access for its C7 sport service to the Foxtel pay TV service has demonstrated that this has not been achieved by the legislation. This is the result of two key deficiencies in the drafting of the relevant provisions:

- Section 152AR(2) currently only applies to "carriers" and "carriage service providers" easily allowing corporate structures to be put in place to insulate key inputs such as STUs from the access regime ;and
- Section 152AR(8) requires access providers to supply any service "necessary" to enable the service provider to supply carriage or content services. The ACCC has given this term a narrow interpretation, ruling that certain elements, such as the SMS of the Telstra/Foxtel analogue pay TV service, are not subject to the access regime on the basis that access seekers are capable of providing such services themselves and that they are therefore not "necessary" and despite clear statements to the contrary in the Explanatory Memorandum to the legislation. This means that an access seeker is required to duplicate much of the technical systems required to interact with Telstra/Foxtel's initial gateway even though such technical arrangements have not been attempted anywhere else in the world and the cost, delays and technical uncertainties act as a significant barrier to entry.

It is commonly thought that analogue STUs are subject to the current access regime. But there are various arguments that STUs can escape the effects of the current regime through ownership arrangements intended to achieve this result. (See **Diagram 1** at **Annexure 4** for an explanation of the ownership arrangements relating to the Telstra/Foxtel pay TV network.) It would be naive to assume that an access provider would not pursue some or all of these arrangements to avoid compliance with the access framework.

It is apparent that the current Telstra/Foxtel pay TV network ownership arrangements were put in place in an attempt to avoid application of the access regime to the STUs. While the High Court has found that the current arrangements do not remove the STUs from the access obligations, it would not be difficult to devise arrangements to have this effect. This could lead to an undesirable situation where consumers would have to purchase a separate STU for each service to which they wished to subscribe. This would require duplication of infrastructure which would pose a cost barrier to new entrants to the industry and to the consumers wishing to purchase the services of those new entrants.

Access to STUs is also critical to the provision of enhanced/interactive television services. It is widely recognised that whoever controls the STU becomes the "gatekeeper" in the provision of broadband services. This is because the STU is the critical interface or portal between the customer and the providers of content services.

The deficiencies in the current legislation identified above must be rectified at the same time that any amendments are made to enable exemptions to be granted in relation to future investments/services. Otherwise, Telstra and Foxtel will continue to use the legal process in an attempt to exploit the uncertainties in the current framework to prevent any access to its STUs and the proposed digital STUs.

The steps required to achieve this result are discussed below.

1.5 Access obligations should apply to all persons who provide declared service or its components, or associated services

In order to provide certainty of access to both STUs and the associated services such as SMS and CAS, it is necessary to amend section 152AR(2) which applies only to carriers and carriage service providers, to impose the access obligations on any person who provides:

- the declared service;
- any component of the declared service; or
- services that are used in connection with the service.

If the amendments do not apply to all of these classes of persons, then as discussed above an access seeker could subvert the intention of the legislation by hiving off particular equipment or components of the service to another person who currently falls outside the ambit of the legislation. They can attempt to do this by exploiting the nexus required in the current legislation that the equipment or service is only caught if provided by a person who is carriage service provider. It is clearly possible to develop structures which circumvent the current legislation in this way.

1.6 Definition of "necessary" services

The scope for a narrow interpretation of section 152AR(8) to exclude service elements such as subscriber management systems (SMS) is clearly contrary to the legislative intent of Part XIC.

The problems identified with this section should be rectified by defining in Part XIC what are considered to be "necessary" elements to supply content services in the context of pay television. Clearly, these elements must include STUs, CAS and SMS. They should also include elements such as memory capacity within the box, processing power, smart cards, disk capacity, API and back channel capabilities.

Further consequential amendments may also be required to cut off other technical legal arguments designed to circumvent the entire operation of s.152AR(8).

As can be seen from the discussion in **Annexure 2**, Seven's proposed legislative mandating of access to STUs and associated services does not constitute new policy, it is merely a continuation of the policy expressed by Parliament in section 39 of the transitional telecommunications legislation in 1997 which required the ACCC to make a deeming statement that was to include a declaration of pay TV services.

1.7 Wholesale and retail access should be provided

The current Part XIC access regime is based on a retail competition model. That is it assumes that access seekers will manage their own customer relationships, such as billing, marketing etc. As such, it does not adequately provide for access seekers to

gain access to services on a wholesale basis, ie to provide a single channel to be included in an existing pay television service.

This retail model is based on certain premises concerning the broader regime for telecommunications regulation that was introduced with the 1997 package of legislation which included the new Part XIC. Those premises reflected expectations that the new regulatory regime would lead to healthy competition in the provision of telecommunications infrastructure and services.

However, in the absence of such a competitive environment, prospective suppliers of pay TV content do not have alternative options for the delivery of their content to end-users. In this environment, the concept of a retail competition model has become less practical. While the option of providing a competitive retail pay television service should remain, changes in the competitive state of the pay television industry mean that a wholesale option is essential if any competition in pay television content services is to exist.

In the digital pay TV context, restriction to a retail only model means that access seekers cannot ensure their channels are included as part of existing pay television services or that they are able to be paid for via an existing billing system. They may not be included in the pay television operator's program guide or EPG, and the access seeker would have to provide its own call centre.

In the US and elsewhere, it is standard practice that access to the pay TV service can be provided on a wholesale model so that access seekers do not have to duplicate such elements because of huge costs associated with establishing those elements. Without access to these elements, an access seeker would be required to incur considerable expense in providing its own billing system, and other systems such as SMA and CAS. This would put the access seeker at a significant competitive disadvantage.

Part XIC should be amended to make it clear that access seekers must provide access on both a retail and wholesale basis, with an access seeker being able to elect the form of access it requires.

1.8 Access seekers must be guaranteed immediate access to digital services

The current declaration process in Part XIC provides significant opportunities for access providers to delay in meeting their obligations.

In Seven's view, any special amendments to the access regime aimed at providing certainty for Telstra/Foxtel in the digitisation of their pay TV network must also guarantee immediate access for access seekers, such as Seven, to the digitised network. Immediate access in this context means as soon as the services are available to any other user of the service, for example, Foxtel.

The key elements allowing for delay to be used as a mechanism to defeat legitimate access requests are:

- The ability of access providers to dispute ACCC service declarations; and
- The need for disputes relating to commercial issues to be resolved before access is granted.

Any disputes on terms and conditions should be resolved after access is provided, otherwise there will be an incentive for an access provider to contrive a dispute in order to delay access. Such delaying mechanisms on the part of access providers are effectively encouraged by the current access regime which requires that the

parties reach agreement on the terms and conditions of access before access is granted. Of course, if agreement is not reached then the ACCC can arbitrate the matter, but in the meantime, access does not have to be provided unless and until the terms of access are settled (see s.152AY).

The history of pay television access policy goes back to 1995. To date, no effective competitive access has been granted to those services.

C7 Pty Limited attempted to gain access to the Telstra/Foxtel analogue pay TV service from September 1999 to its closure on 7 May 2002. Even though access to this service was mandated since the beginning of the access regime under Part XIC of the TPA, and in spite of a number of Federal Court decisions and a High Court decision in effect confirming those obligations, C7 still did not gain effective access to that service.

The intent of the declaration of analogue subscription television services was to introduce competition – this has not happened.

In Seven's view, it is necessary that immediate access to the digital pay television platforms and services be legislatively mandated and not left to the declaration process currently provided under Part XIC of the TPA.

The earlier an advantage is gained in relation to digital services and the longer it is held, the more likely it is that there will not be effective competition in the use of those services. Any delay in ensuring that access to digital services will be mandated will have a profoundly detrimental effect on competition in the provision of digital services, particularly non-broadcasting services.

Analogue is not a viable option for prospective pay TV content service providers because the start-up costs involved in establishing all the essential elements of an analogue service are prohibitive. In the absence of provision for a seamless migration to digital, any new analogue service would have to shut down before those start-up costs have been recovered. The limited amount of time before the transition to digital does not allow a viable business model to be devised for analogue services. This effectively defeats the intention of the current analogue pay TV access regime because any access seeker who gains access to the analogue service will not be able to continue to provide their service when Telstra/Foxtel migrate to digital mode and would be required to shut down its analogue service.

The Bill should include further amendments to provide certainty as to the commencement date for the obligation to provide access (that is, at same time as any other user, including the access provider, gets access to the digitised pay TV network). The legislative mechanism employed for this immediate access should provide for the making of a subordinate legislative instrument, preferably regulations which could be prepared for commencement at the same time as the relevant amendments in the Bill, to specify the digitised services to which immediate access must be provided. This will bypass the current ACCC declaration process to avoid any further delays in access being provided to the digitised Telstra/Foxtel pay TV network.

1.9 Amendments should be platform neutral for all platforms used for pay TV

Any amendments to the access regime for pay TV services should not be tied to any particular delivery mechanism for pay TV, but should be neutral in terms of the delivery mode.

This takes account of the fact that media convergence, particularly in relation to Telstra's extensive vertical and horizontal integration, has led to a number of digital delivery platforms being utilised for the provision of pay TV services, for example, cable, satellite, ADSL.

1.10 Technical impediments to access

A further avenue to defeat legitimate access requests exists in the technical parameters of any service deployed by the access provider. It is imperative that the Government introduce provisions into Part XIC to require providers of digital pay television networks to implement their digital conditional access system and other technical elements in such a way that permits access by access seekers without extensive modification to the system/network. The technical configuration must accommodate immediate access for those who wish to use the digitised services, or for those who wish to access the digitised network in order to provide their own services.

If an access provider is not required to design its digital network in such a way as would facilitate access, there can be extensive delays in the provision of access amounting to a defacto access holiday.

Experience with the introduction of mobile number portability shows that such an amendment is required. Telstra's mobile network, as originally configured, facilitated number portability between Telstra's network and the networks of other mobile carriers. Telstra had its network reconfigured in such a way that number portability was technically very difficult. The introduction of mobile number portability was delayed due to the technological adjustments that had to be made as a result of the configuration of Telstra's network. Telstra took the position at the time that it would have ensured that its mobile network readily allowed number portability if it had know that portability would be required – this is in spite of the fact that the legislation required the introduction of portability.

Telstra/Foxtel's current analogue conditional access system is also configured in a manner that requires extensive modification if an access seeker uses a separate SMS. It is relevant to note that Telstra initially commissioned the design of a open system for the pay television network. This system was demonstrated and trialled. However the open architecture design was changed to the current proprietary analogue configuration when News Limited joined the Foxtel partnership.

It is more efficient and less expensive to configure the original digital conditional access system and related services for open access, rather than try to make modifications to the system when it is already operational.

Amendments to the access framework are required to require technical access to be immediately available without the need for major technical modifications. Access providers should be free to choose whatever equipment they wish as long as this immediate technical access is available.

One legislative option may be to provide for an independent technical expert, appointed by the ACA, to check the technical aspects of the digitising of the Telstra/Foxtel network for compliance with any interconnection standard, or, in the absence of a standard, to ensure that third party access will be readily technically feasible. This could be supported by an amendment requiring the making of interconnection standards under s.384 in Div 5 of Part 21of the Telecommunications Act 1997 to address this issue. While the Explanatory Memorandum for Division 5 makes it clear that the making of such standards should only be done as a last resort for technical matters, it also makes it clear that it is an appropriate step to take where

the operation of the access regime has failed, which it clearly has in relation to access to pay TV.

1.11 Any special amendments to encourage digitisation must apply to future investments only

Any amendments relating to pricing certainty for new investments should apply only to the necessary new investments such as STUs, and should not apply to the existing broadband cable itself, for the following reasons.

Telstra rolled out the hybrid fibre coaxial cable (HFC) network in the full knowledge that it would be required to provide access to that network, and for the principal purpose of defending its position in the provision of telephony services (see the discussion of this in **Annexure 3**). Therefore, the HFC network is an old investment the business model of which took account of the expected access obligation.

The rollout of the Telstra HFC network was conducted using principally public funds. Immediately before the sale of the first tranche of Telstra shares, Telstra effectively wrote off approximately 88%, or $1.6 billion, of the costs of the HFC rollout. Telstra's audited financial statement for the financial year ended 30 June 1997, revealed that the historic cost of the HFC network was $1.811 billion, which was written down to $210 million or 11.6% of the historic book value. In Seven's view, it would be wholly inappropriate for Telstra, under the guise of pressing for amendment to the access regime for new digital investment, to recoup an early investment that it has effectively written off, as that would require access seekers to contribute to Telstra's costs of defending its telephony position. It would also result in an access price that is uneconomic for access seekers to use.

The costs of digitising the Telstra/Foxtel pay TV network will principally be for upgrading or replacing STUs and related equipment, currently used for the provision of the Foxtel pay TV service, to provide for digital functioning. Therefore, it is the digital STUs to which any special pricing certainty amendments to the access regime should apply, not the existing HFC network or other investments.

1.12 Mechanics of pricing certainty

To the extent that any amendments are designed to provide commercial certainty on the access price for digital STUs, those amendments must accord with the following:

- the amendments must specify a simple formula, or other clear mechanism, so that the financial terms are known to both access providers and access seekers.

There are numerous mechanisms available to achieve this. One common mechanism (such as that adopted by the Federal Communications Commission in the United States in respect of cable infrastructure) would be to specify in advance (i) a guaranteed rate of return on capital that an access provider would be allowed to charge access seekers for its future investment in digital STUs; and (ii) how that rate is to be apportioned to access seekers (for example, based on the number of channels used):

- the amended regime should <u>not</u> leave any matters to the discretion of the access provider (for example, rate cards to be determined by that access provider);
- the regime to be adopted for pricing certainty should not be a backdoor for an access holiday (see the discussion of access holidays at **Annexure 5**)

- any delays in the provision of access whether due to pricing uncertainty or because of the requirement for technical alterations to facilitate access would amount to a defacto access holiday which would effectively be a reversal of the current policy of the current pay TV access regime;
- to the extent that there are any variables in the application of the formula (for example, to work out the capital base, inflation or depreciation), there must be a legislative requirement for immediate access, with any dispute as to the application of the pricing formula to be determined later.

1.13 Conclusion in relation to amendments relating to investment certainty and access to digital services

The following actions are necessary to ensure access to digital services is provided to third parties:

- guarantee access to digital STUs and associated systems (including SMS and CAS);
- apply the access obligations to any party who is involved in the supply chain for providing pay TV services to customers;
- ensure that access is provided on both a retail and wholesale basis, with access seekers being able to elect which form of access they require;
- provide a legislative guarantee of immediate access to the digitised pay TV service for access seekers, bypassing the declaration process, with any disputes on terms and conditions to be resolved after access is provided;
- require the implementation of the digital conditional access system to be designed in such a way that facilitates ready access without the need for extensive technical modifications;
- ensure that the pay TV access obligations be technology neutral in relation to the platform used to provide pay TV services;
- apply any financial certainty provisions to future digital investments only and not to the broadband cable itself; and
- specify a simple formula or other clear mechanism that allows the financial terms of access to be known to both the access provider and access seekers, without any matters being left to the discretion of the access provider.

2 Telstra Accounting Separation

Part 16 – Record-keeping rules and disclosure directions

(a) Item 124 - After section 151BU (New sections151BUAA and 151BUAB)

Seven supports measures being taken to address the level of vertical integration in Telstra's wholesale and retail services, and more particularly, Telstra's extensive vertical and horizontal integration across a wide range of communications and media sectors.

The degree of Telstra's media integration has had a serious anti-competitive effects in relation to the provision of pay TV services. C7 has been attempting to gain access to the Telstra/Foxtel pay TV network for 5 years and still has not been successful.

The Explanatory Memorandum to the Bill states that the proposed accounting separation measures in Part 16 of the Bill will address competition concerns arising from the level of Telstra's vertical integration. Implicit in this is the expectation that accounting separation would contribute to achieving that goal by imposing a greater level of accounting transparency on Telstra to ensure that Telstra's competitors are on a 'level footing' with Telstra's retail arms when it comes to purchasing wholesale services from Telstra's wholesale arms.

However, the regulatory device of accounting separation has been tried and failed overseas. The worldwide trend is now towards structural separation which is seen to be the only truly effective means of addressing the anti-competitive consequences of incumbent vertical and horizontal integration.

European Commission

In 1995, the European Commission (the Commission) issued a directive[1] (the Cable Directive) to remove the restrictions on the use of cable TV networks for the provision of telecommunications. The prime purpose of the Cable Directive was to encourage more competition in the provision of telecommunications services through increasing the available amount of carriage capacity for such services[2].

But the Cable Directive also recognised that, where an undertaking that still has a role in the provision of reserved services and has established both cable and telecommunications networks, it has no incentive to attract users to the most suitable network for the provision of a relevant service, as long as the undertaking has spare capacity on the other network[3]. In such a situation, it was considered that the undertaking would have an interest in overcharging for the use of its cable network to provide services that are open to competition so as to increase traffic on its telecommunications networks[4].

To address the potential for a dominant provider to use cross-subsidies in an anti-competitive way, the Cable Directive also provided that there should at least be a requirement for accounting transparency through the keeping of separate financial records between the provision of services[5]. It is important to note that the

[1] Commission Directive 95/51/EC of 18 October 1995 (the Cable Directive).

[2] See paragraphs 2, 10, 12 and 13 of the Cable Directive.

[3] See paragraph 18 of the Cable Directive.

[4] Ibid.

[5] See paragraphs 18 and 19 of the Cable Directive.

Commission's preferred regulatory approach was to require full structural separation[6].

In 1998, after reviewing the effectiveness of the measures taken in response to the Cable Directive, the Commission found that the accounting separation measures were not sufficient to facilitate pro-competitive development[7]. The Commission advised that telecommunications and cable businesses should, at least, be legally separated[8]. The Commission again concluded that the best results for effective competition would only be achieved by full divestiture by dominant telecommunications operators of their interests in cable TV[9].

As a result of the 1998 review, the Commission issued a directive in 1999[10] (the 1999 Directive) requiring telecommunications companies to legally separate from their cable activities, and has indicated that it would assess whether full divestiture was required on a case by case basis[11].

It is interesting to note, in the context of the proposed digitisation of the Telstra/Foxtel cable network, that the preamble to the 1999 Directive recognises that where a dominant operator has both narrow and broadband networks, it has no incentive to upgrade both networks to integrated broadband networks, because to upgrade one network may lead to a loss of business in the other[12].

Subsequent to the 1999 Directive, a number of European telecommunications entities have been required or encouraged to divest their cable enterprises, some examples being:

- the *Telia/Telenor* merger where Swedish Telia and Norwegian Telenor undertook to divest themselves of their respective cable-TV businesses and other overlapping businesses to gain the Commission's approval for the merger[13];
- in the Netherlands, KPN[14] was required by the Dutch government to divest its cable holdings from 100% to at least 20%. To this end, it formed the wholly owned VisionNetworks in order to group all of its cable holdings (Telecential, ComTel, Casema in Holland, RCS in France, as well as Czech and Polish operations) to make them a more attractive purchase. Subsequently, KPN decided to divest all of its holdings, selling them to France Telekom[15];

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[6] [6] See paragraph 18 of the Cable Directive.

[7] See Commission Communication concerning the review under competition rules of the joint provision of telecommunications and cable TV networks by a single operator and the abolition of restrictions on the provision of cable TV capacity over telecommunications networks (98/C 71/04) in the Official Journal of the European Communities, C 71, 7 March 1998, pages 4-22.

[8] Ibid.

[9] Ibid.

[10] Commission Directive 99/64/EC, 23 June 1999 (The 1999 Directive), adopted by the European Parliament on 9 February 1999 (OJ C 150, 28/5/99, p. 33).

[11] European Commission XXIXth Report on Competition Policy 1999, page 37.

[12] See paragraph 10 of the 1999 Directive.

[13] See European Commission Press Release IP/99/746 (13/10/99) "Commission clears merger between Telia (Sweden) and Telenor (Norway) with substantial conditions".

[14] the holding company of Dutch incumbent, PTT Telekom.

[15] "1 May 1997, Netherlands: buy-out precedes sale", Cable Business International, C/C 9/97 5/97, page 3; "KPN buys out partners in Dutch cable sector shake up", Sheridan Nye, 12/3/97 (www.totaltele.com); The 2001 OECD Report, see note 8, page 43.

- in Germany, Deutsche Telekom (DT) took steps to comply with the 1999 Directive before it came into effect, and decided to sell part of its 9 regional cable networks. Various newspaper sources report that DT was pressured by the European Commission[16]. European Commission sources suggest it did so voluntarily in its best interests[17].

There have been indications that the Commission will continue to require divestiture, or separation, to address real or potential anti-competitive behaviour[18].

OECD

In a report in 2001, the Organisation for Economic Co-operation and Development indicated that it favoured requiring structural separation as a most effective regulatory device for addressing the incentive of an incumbent telecommunications operator to engage in anti-competitive behaviour[19].

The 2001 report argued that access regulation is a behavioural approach, as opposed to ownership separation which is a structural approach, that struggles to address the incentives of an incumbent to devise ways to minimise competition.[20] Even a well-resourced, persistent and vigilant regulator is unlikely to achieve an outcome that would provide as much competition as would likely arise where there is no incentive to restrict competition.

The 2001 report also notes that regulatory devices such as requiring accounting separation, management separation, or corporate separation, do not address the incentive of incumbents to resist competition. Indeed, the report states that:

> "These approaches are therefore not effective in promoting competition in themselves. This point has been made many times in many different industries." [21]

Accounting separation for Telstra

Telstra is already required to keep separate accounts[22]. Senator Alston has indicated that discussion will be conducted with Telstra and the wider industry on the precise nature and extent of the proposed accounting separation[23].

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[16] "EU forces dominant phone companies to separate cable activities", Alison Jahncke, Bloomberg News, 23/6/99; "Telekom to spend DM400 mln on cable upgrades in 2000", Sonja Heizmann, Bloomberg News, 30/8/99; "Bidders for Telekom cable sale emerge in the first round", Vanessa Clark, 23/8/99 (www.totaltele.com); "Newscorp bids for entire Deutsche Telekom cable network", Christine Harper, Bloomberg News, 23/8/99; "Deutsche Telekom fears over EC study", Network briefing C/C 10/98, 24/1/97.

[17] European Commission Press Release IP/00/637 (20/6/00): "Commission clears Deutsche Telekom's first sale of a regional cable TV network in Germany"; The 2001 OECD report, page 37.

[18] Mario Monti, quoted in 1999 Commission Press Release on Telia/Telenor merger (above): "This is unlikely to be the last time we will require cable TV network divestitures and/or local loop unbundling to resolve competition issues"

[19] See OECD, Directorate for Financial, Fiscal and Enterprise Affairs, Committee on Competition Law and Policy, Structural Separation in Regulated Industries – Report by the Secretariat, 10 April 2001 (DAFFE/CLP (2001) 11), pages 48 and 49.

[20] Ibid.

[21] Ibid.

[22] See the Telecommunications Industry Regulatory Accounting Framework (Record-keeping rules) issued by the Australian Competition and Consumer Commission under section 151BU of the Trade Practices Act 1974 (Cth).

[23] See the Minister's media release of 24 April 2002, op cit.

The Explanatory Memorandum to the Bill throws no light on why it can be expected that the measures in Part 16 will actually achieve the improvements in competition that have eluded similar regulatory strategies in other countries.

If the keeping of separate accounts has not yet affected Telstra's anti-competitive behaviour, in the absence of further, more fundamental competition reforms, there do not appear to be any grounds for optimism in relation to the proposed accounting rules in Part 16.

Conclusion

The only viable long-term option for addressing the anti-competitve consequences that flow from vertical integration of incumbent telecommunications providers, is to require structural separation, both in relation to the wholesale and retail arms of . an infrastructure provider, and in relation to its infrastructure and content service arms. Such mandated structural separation should also apply to all infrastructure providers, such as Foxtel, not just Telstra.

Annexure 1 - Technology Neutrality

The language of Part XIC of the TPA is technology neutral in that it imposes access obligations in relation to declared carriage services. The obligation imposed on the ACCC to make a deeming statement of declared services under s.39 of the transitional telecommunications legislation in 1997 is also technology neutral:

> "39(5) The ACCC must also specify in the statement an eligible service that is:
>
> (a) necessary for the purposes of enabling the supply of a broadcasting service by means of a line links that deliver signals to end-users…"

The Explanatory Memorandum to s.39 sates that:

> "This is intended to require the ACCC to include in its statement, and thus provide regulated access under Part XIC to, a service for the carriage of broadcasting (particularly, subscription television broadcasting services) over cable networks generally."

The major political parties have long embraced the policy that telecommunications and pay TV regulation should not be technology specific.

This is because of the rapid pace of technological advancement in telecommunications and pay TV which has the potential to swiftly render regulatory attempts obsolete.

It is also because in the telecommunications and pay TV industries time is of the essence. Access delayed is access denied. Delays in obtaining access entrench the position of incumbents, thereby defeating the purpose of the regime by stripping access-seekers of the intended benefits of access and making it difficult, if not impossible, to generate competition from access-seekers at a later date.

This was recognised by Parliament when it introduced the current regime. In the Second Reading speech, Warwick Smith MP stated that:

> "The fast pace of change and complex nature of horizontal and vertical arrangements of firms operating in this industry mean that anti-competitive behaviour could cause rapid damage to competition that has already developed and severely hamper new entry."[24]

It was not intended that access be confined only to the analogue platform. That technology was adopted because Parliament required the ACCC to immediately, on day one of the new regime, declare access to whatever platform was currently in use.[25]

The **Coalition** has long advocated that telecommunications and/or pay TV policy must be technology neutral. While many of the statements predate the current platform structure, they reflect the long-term policy that regulation in this area should not be tied to technology:

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[24] Trade Practices Amendment (Telecommunications) Bill 1996: Second Reading, House Hansard, 5 December 1996: page. 7804.

[25] By means of section 39(5) of the Telecommunications (Transitional Provisions and Consequential Amendments) Act 1997; see Telecommunications Bill 1996, Trade Practices Amendment (Telecommunications) Bill 1996 et al: Second Reading Speech, Senate Hansard, 25 February 1997, pages 948 and 953.

- "There will be:... no technology specific restrictions or prescriptions…there will be an open access regime [that] will ensure that all [new]comers have access to the telecommunications capacity of all carriage service providers on fair and reasonable terms."[26]
- "It should be noted that this government favours a technology neutral approach towards telecommunications regulation in order to accommodate the rapid rate of technological change endemic to this industry."[27]
- "Some key elements of the government's competition policy are…a genuinely technology neutral approach to regulation."[28]
- "The Carrier Associates Direction" will be reviewed by the Coalition to determine whether, in line with our policy of technology neutrality, the pro-competitive provisions of the Telecommunications Act should be extended to cover interactive services delivered over any media … A broad-based technology-neutral transmission right designed to ensure that content providers obtain a fair return for their commitment of money, time and energy, will be introduced."[29]
- "After the Fraser government's decision to open Australia after subscription television, Labor nonsensically delayed the implementation of this decision for almost a decade. When it finally took the plunge, it shut out some technologies, anointed others, and introduced unworkable ownership arrangements. The Coalition will adopt a technology neutral approach to new subscription television services. We will not arbitrarily prescribe the delivery technologies to be used by broadcasters."[30]
- "In government our key goals for communications will be: ... in the light of converging technologies, provide a regulatory framework in which maximum competition facilitates the development of relevant and cost-efficient technologies for all Australians.[31]
- "In December last year, the [Labor] government called for tenderers for six pay TV microwave licences…throughout the whole process it was always clear that the government wished to have a technologically neutral approach to the pay TV industry."[32]
- "The Coalition has always maintained that a technology neutral stance is the appropriate one. We do not believe it is this parliament's role to do anything

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[26] Senator Richard Alston (Minister for Communications and the Arts), Address to the National Press Club: "Open competition", 12/3/97: page 3 (emphasis added).

[27] Senator Susan Knowles, Telstra (Dilution of Public Ownership) Bill 1996: Second Reading: Senate Hansard, 28 October 1996: page 4603 (emphasis added).

[28] Senator Richard Alston (Minister for Communications and the Arts), Address to Connections Means Business, 4/9/96: page 4 (emphasis added).

[29] Coalition policy document: "Australia Online", 27/02/96: Executive Summary (emphasis added).

[30] Coalition policy document: "Better communications", 23/01/96: page 15 (emphasis added).

[31] Coalition policy document: "The things that matter – Coalition goals (Supplementary papers)", September 1994: page 15 (emphasis added).

[32] Senator J Tierney, discussion of pay television: Senate Hansard, 18 May 1993: page 727 (emphasis added).

less. In other words we are not about trying to favour one technology over another."[33]

- "Communications in Australia has been characterised by mandating the technologies and carriage of communication services…the Coalition is committed to putting the public interest in consumer choice first. Our policies are technology neutral."[34]
- "We have always been totally against exclusivity periods, particularly so in an area where technologies are advancing so rapidly…the overall objectives of the coalition's communication policy…of greater competition…and allowing new technologies would appear to be met by Optus's proposal [to go straight into digital compression technologies]."[35]

As far back as 1991, **Labor** maintained a substantially similar view over the same period in relation to satellite licensing and, with the advent of cable, in relation to access:

- "I will concede that the Prime Minister (Mr Keating) was absolutely correct…all along in saying that one cannot lock out one form of technology from another in this, because it is all moving too fast."[36]
- "the Government therefore sees considerable merit in moving to licence channels, as Optus wished, as a way of providing a flexible regime that is technology neutral and allows for the appropriate regulation of ownership capacity." [37]
- "The fundamental error in British system was the focus on privatisation [and] the over-focus on technology [at the expense of] services. In contrast, the Australian regime will be effectively neutral in terms of technology."[38]
- "Attention has been paid to making the [Telecommunications] Bill as technology neutral as possible."[39]

The **Democrats** have supported the major parties' policy of technology neutrality:

> "We have to have a national service which is technology neutral…we want to set up a level regulatory playing field for satellite, microwave and cable, and for every other type of pay TV delivery system which could be in existence soon."[40]

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[33] Senator H Chapman, Broadcasting Services Amendment Bill 1993: Senate Hansard, 13 May 1993: page 518 (emphasis added).

[34] Warwick Smith MP (Shadow Minister for Communications), Speech at inaugural Liberal St Kilda Road Branch, luncheon meeting: "Signposts to the future – telecommunications", 16/02/93: page 4 (emphasis added).

[35] Warwick Smith MP (Shadow Minister for Communications), Media Release: "Pay TV: Optus proposal vindicates Coalition on competition", 3/09/92 (emphasis added).

[36] Mr N.P. O'Keefe, discussion of pay television: House Hansard, 14 October 1992: page 2133 (emphasis added).

[37] Senator Robert Collins (Minister for Transport & Communications), discussion of pay television: Senate Hansard, 13 October 1992: page 1663 (emphasis added).

[38] Kim Beazley MP (Minister for Transport & Communications) quoted by Joanne Gray in "Competition, Aussie Style", Australian Financial Review, 12/09/91 (emphasis added).

[39] Kim Beazley MP (Transport & Communications), Question without notice on telecommunications, House Hansard, 5 March 1991: page 1262 (emphasis added).

[40] Senator Vicki Bourne, Broadcasting Services Amendment Bill 1993: Senate Hansard, 13 May 1993: page 513 (emphasis added).

Annexure 2 - Set-Top Units (STUs) and Subscriber Management Systems (SMS) – history of access policy

The original policy objectives for the current pay TV access regime were to ensure:

- 'open access' to pay TV services;
- that the access obligations apply to pay TV as an 'end-to-end' service that includes the whole of the pay TV service supply chain to customers; and
- a competitive environment in the provision of pay TV services in Australia.

These objectives were applicable in the context of the intended regime of competition in infrastructure and services. However, with the new deal between Telstra/Foxtel and Optus, the situation could change, so that Telstra/Foxtel would become the monopoly provider of pay TV content and the controller of the means to deliver that content.

The original legislative intention of the access regime is reflected in the **Explanatory Memorandum** and in the **Second Reading Speech** for the bill which introduced Part XIC into the Trade Practices Act 1974.

The Explanatory Memorandum makes it abundantly clear that STUs and associated services were intended to be included in the access regime:

- "Part XIC establishes an industry-specific regime for regulated access to carriage services.

  The industry-specific nature of this regime reflects the particular policy interests in:

  …

  - ensuring access to carriage services is established on reasonable terms and conditions and includes necessary ancillary services such as physical interconnection, billing information and access to conditional access customer equipment (such as set top boxes used in the supply of pay television)."[41]
- "Proposed s.152AR(8) requires access providers supplying active declared services by means of conditional-access consumer equipment (such as set-top boxes used for the supply of pay television), when requested by a service provider who has made a request under proposed s.152AR(3) to be supplied with that active declared service, to also supply any services necessary to enable the service provider to supply carriage or content services by means of the conditional access customer equipment using the active declared service.

Possible examples of the necessary services include: access to a subscriber management system which manages the services that customers are authorised to receive via conditional-access customer equipment; provision of necessary technical information about the conditional-access system; or access to, or information about, 'smart cards' used to control access by customers and/or billing."[42]

[41] Trade Practices Amendment (Telecommunications) Bill 1996: Explanatory Memorandum, page 39

[42] Ibid, page 50.

Similarly, the **Second Reading Speech** leaves no doubt that the legislative intent was to include STUs and SMS:

- "The Government does not intend to allow any industry participants to avoid legitimate access requirements through artificial arrangements. Furthermore, service providers now have the ability to control services through which regulated access is appropriate and this will increase in the future ... At the request of an access seeker, an access provider must supply the declared service, interconnection and associated services."[43]

This legislative intent reflects long standing **Coalition policy** to the same effect:

- "From 1 July 1997 the Coalition will provide open access to cable infrastructure so that subscribers will be able to access more than one pay TV operator through their chosen cable company…with the advent of digital broadcasting for television and radio the coalition will take necessary action to avoid the chaos which went with Labor's attempt to introduce satellite pay TV to Australia."[44]
- "Open access means that customers should not be denied access to particular services simply because they use a particular infrastructure provider. Infrastructure providers should be required to provide connection between service providers and customers within a non-discriminatory commercial framework. The government's closed access approach to subscription television has led to an absurd situation where Optus Vision customers will be denied access to programs exclusively available on Foxtel channels and vice versa, not to mention the exclusion of all independent television services from cable all together. The only way to get both sets of channels will be to have two set-top boxes on a television, and two cables coming to the premises…the Coalition will require subscription television network operators…to provide access to their infrastructure under a compulsory interconnect regime, in line with the regime for telephony and interactive services."[45]
- "The right to deny connection to an independent interactive service provider on the basis of 'reasonably anticipated requirements' is also a serious source of concern for the Coalition and the industry …We will open up Labor's closed access regime in order to promote an independent interactive multi-media service provider industry. The Coalition will ensure that competition extends into the subscriber and service management business. The communications network will become an open platform for the deployment of a variety of independent services and independent service management systems, competing for customers on a level playing field."[46]

The current access regime also reflects a long line of parallel **Labor policy**:

- "Yesterday's policy statement by Lee indicated that Optus and Telstra would enjoy monopoly pay TV rights on their particular loops until 1999 at the latest.

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[43] Telecommunications Bill 1996, Trade Practices Amendment (Telecommunications) Bill 1996 et al: Second Reading Speech, Senate Hansard, 25 February 1997, page 948.

[44] Senator Richard Alston (Shadow Minister for Communications), Media Release: "Coalition announces framework for a coherent media policy", 23/01/96.

[45] Coalition Policy document: "Better Communications", 23/01/96: page 36.

[46] Coalition policy document: "Australia Online", 27/2/96: page 9.

After that time they will have to provide open access not only to the loop but also to the set-top boxes and the installed billing systems."[47]

- "To enable the new entrant to compete effectively...Telecom will be required [:] … to provide all relevant ancillary and supplementary services including billing, operate and directory services, and customer information required by the designated carrier."[48]
- "Pay TV needs costly and sophisticated central subscriber databases, control systems and technology to turn subscribers 'on' or 'off' and to bill them. All licensees are free to operate their own subscriber management systems but will be required by a license condition ... to provide access for other operators to their systems at a fair price."[49]
- "16. A carrier must provide interconnection of its network facilities to networks of other carriers; and has a right to have other carriers supply telecommunications services to it for the purposes of its supply of those and/or other telecommunications services; and to gain access to supplementary services and facilities including ducts, network information and customer billing.

  ....

  22. To facilitate access to customers:

  (a) a carrier or service provider must make customer equipment it owns – or for which it specifies the technical characteristics – accessible to other carriers or service providers (for example, there must be open access to carriers' and service providers' set top boxes);

  (b) any carrier or service provider operating a subscriber management system used to control or manage access to video, audio or interactive services must provide access to that system at a fair price. [50]"

In fact, in 1992 when only satellite pay television was being considered, Senator Alston strongly criticised the then Labor government for inadequately guarding against vertical integration of pay television licensees and monopoly control of the subscriber management system.[51]

More recently, this bipartisan concern at preventing the monopolisation of pay television has been echoed in the context of Digital Free-to-Air television STUs. In 1998 the Senate Committee charged with investigating the basic framework to be adopted for the conversion from analogue to digital television transmission stated that:

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[47] Max Walsh, " 'Greatest Scam' looks like a goer", Sydney Morning Herald, 2/08/95: page 37 (emphasis added). (Discussion of Communications Minister Michael Lee's announcement of post-1997 telecommunications policy).

[48] Kim Beazley MP (Minister for Transport and Communications), Policy Release: "Micro-economic reform: progress telecommunications", November 1990: page 4.

[49] Mr S.P. Martin MP, Broadcasting Services (Subscription Television Broadcasting) Amendment Bill 1992: Second Reading, House Hansard: page 3742.

[50] Labor policy document released by Michael Lee MP (Minister for Communications and the Arts): "Telecommunications policy principles – post 1997".

[51] Broadcasting Services (Subscription Television Broadcasting) Amendment Bill 1992 et al: Second Reading, Senate Hansard, 24 November 1992, page 3360.

> "consumers must not be disadvantaged by being required to purchase additional equipment, and ... competition should not be stifled by proprietary [conditional access] systems."[52]

[52] Australian Senate Environment, Communications, Information Technology and the Arts Committee: Report on the Television Broadcasting Services (Digital Conversion Bill 1998 and Datacasting Charge (Imposition) Bill 1998, Paragraph 2.76. See: http://www.aph.gov.au/senate/committee/ecita_ctte/tv/Index.htm.

Annexure 3 - Current legislative safeguards for investment certainty

Part XIC of the Trade Practices Act 1974 already provides for certainty in relation to network investments in two respects:

- the ACCC is required to have regard to incentives for economically efficient investment in infrastructure (s.152AB), and to the legitimate business interests of an access provider's investment in network facilities;
- an access provider may submit an access undertaking under s.152BS, that deals with access pricing, to the ACCC for approval where the ACCC considers the terms and conditions of the undertaking to be reasonable (Div 5 Part XIC).

These provisions should be sufficient to provide financial certainty to potential investment in the digitising of the Telstra/Foxtel pay TV network. Telstra/Foxtel's legitimate business interests in digitising their network would not be harmed by any requirement to provide access to the digitised network.

It has been argued[53] that this does not provide certainty for potential investors because undertakings can apply only to declared services, and declaration can only occur for an existing service, that is, after the investment has been made. But this ignores the efficacy of the existing legislative protections. Any Telstra/Foxtel access undertaking lodged with the ACCC would be enforceable as long as it is consistent with the standard access obligations, **and** the terms and conditions are reasonable (see s.152BV).

There is no evidence that the existence of the current access regime has acted as a disincentive to investment in new infrastructure, or the upgrading or modification of existing infrastructure. Rather, investment practices to date suggest that the existing legislative safeguards have been considered by pay TV and broadband infrastructure investors to be no impediment to their investments.

At the time the Telstra hybrid fibre coaxial (HFC) cable was laid it was the common policy of both the government and opposition parties to provide an open access regime to the cable after a limited exclusive period for the builders of the cable.[54] Each of Telstra and Optus made their investment decisions to roll out their HFC networks on that basis. Telstra's main reason for rolling out the network was to defend its telephony position, particularly in relation to local calls.

Indeed, Telstra's CEO has acknowledged that Telstra's "strategic planning has been and is predicated on that assumption", namely, of open competition from 1997.[55] Furthermore, both the government and opposition parties have at all stages indicated they would adopt a technology neutral approach to pay television services.[56]

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[53] See the Productivity Commission's final report on Telecommunications Competition Regulation, page 286.

[54] Address by Michael Lee MP, Minister for Communications and the Arts, to IIR Conference, "Telecommunications – towards 1997 and open competition", 24 November 1994.

[55] Address by W Frank Blount, Telstra CEO, to the National Press Club, "Communications – unlocking the future", Canberra, 31 May 1995.

[56] See Michael Lee, op cit. See also, the Hon KC Beazley, Minister for Transport and Communications, in response to a question without notice, House of Representatives, Hansard, 5 March 1991, page

The cost of digitising the HFC cable is relatively small compared to the original investment – which was made on the assumption that the HFC cables would be used for digital technology in the medium term. Accordingly, the bulk of the investment has already been made on the assumption by Telstra and Optus that the HFC cable would be subject to open access for digital pay TV.

Also, Telstra has been rolling out other significant broadband infrastructure investments such as the CDMA mobile network and the ADSL service, without any apparent restraint due to the existing access regime.

However, there may be some merit in amending the current regime to allow the s.152BS undertaking process to operate without a declaration having first been made. This would provide the certainty that was intended by the regime prior to investment decisions being made.

1262. Also, Mr Beazley's remarks as reported by Joanne Gray, "Competition, Aussie style", Australian Financial Review, 20 November 1991. Also, the Hon PJ Keating, Prime Minister, in response to a question without notice, House of Representatives, Hansard, 4 June 1992, page 3585. Also, WL Smith, Liberal Party, during the second reading debate of the AUSSAT Repeal Bill 1991, House of Representatives, Hansard, 10 September 1991, page 1007. Also, Senator Alston, Liberal Party, during the second reading debate of the Broadcasting Services Amendment Bill 1993, Senate, Hansard, 13 May 1993, page 509.

Annexure 4 – Ownership of Telstra/Foxtel pay TV network

See the accompanying **Diagram 1** for the ownership arrangements for the Telstra/Foxtel pay TV network.

Under the current analogue subscription television arrangements, Foxtel leases the STUs from the Commonwealth Bank of Australia (which has 97% ownership of the STUs) used for the provision of the Foxtel services, whereas Telstra owns the cable and the "smart card" that is inserted into the STU and is integral to the operation of the STU. It is apparent that these ownership arrangements were put in place in order to avoid application of the access regime to the STUs.

Annexure 5 – Problems with digital access holidays

Telstra/Foxtel position

Telstra and Foxtel have argued that

- they should be granted an 'access holiday' in relation to digital pay TV; and
- the digitisation of the Telstra/Foxtel pay TV network will not be undertaken unless and until such investment is protected from having to provide access on "uncommercial terms".

Seven's position

Seven is wholly opposed to any access holiday.

- there is no commercial need for an access holiday;
- an access holiday would permanently entrench the existing monopoly position of Telstra / Foxtel / PBL / News; and
- an access holiday would amount to an effective repeal of the current access regime and be wholly inconsistent with the long standing policies of both the government and opposition.

Access on "uncommercial terms"

There is nothing in the Trade Practices Act 1974 access regime that requires an access provider to provide access on uncommercial terms

- the legislation specifically requires the Australian Competition and Consumer Commission (ACCC) to have regard to the "incentives for investment in infrastructure" and "legitimate commercial interests of" suppliers of declared services.

Analogue turnoff

- When Foxtel does eventually digitise, it intends to phase out its analogue pay TV service
  - under the existing access regime, neither Foxtel nor Telstra would then be obliged to provide access to analogue pay TV access seekers after the transition to digital;
  - if a digital access holiday were granted, this would have the effect of precluding any alternative content providers, which would effectively repeal the pay TV access regime;
  - given that digitisation is imminent, there is no rational business case for any party to establish an analogue service at this time, unless a smooth transition to digital is mandated by the legislation.

Delays in granting access

- The history of access to pay TV services goes back to 1995, with the result to date that there is no effective competitive access that has been granted to those services. This suggests that the dominant providers of pay TV services in Australia, who have been united in their broadband strategy since 1995, do not have any intention of providing access to any broadband services under their control.

- The intent of the declaration of analogue subscription television services was to introduce competition – this has not happened.
- The access holiday implemented in the original legislation was intended to finish in 1997. Telstra and Foxtel have effectively extended that access holiday by delaying access to access seekers such as C7 for an additional five years.
- Access delayed is access denied. Delays in obtaining effective access serve to entrench the position of incumbents, defeating the purpose of access regimes. This makes if difficult, if not impossible for access seekers to compete at a later date.
- The earlier an advantage is gained in relation to digital services and the longer it is held, the more likely it is that there will not be effective competition in the use of those services
  - any delay in ensuring that access to digital services will be mandated will have a profoundly detrimental effect on competition in the provision of digital services, particularly non-broadcasting services.
  - In the absence of any requirement to grant access to non-affiliated parties, Telstra could quickly establish itself as the unassailable provider of digital carriage services and the services provided via those carriage services. Also, Foxtel would gain a protected first mover advantage in the provision of digital pay TV.

Use of public assets

- The Telstra cable network, has been established using public funds
  - even after digitisation, the majority of the Telstra cable network will have been publicly funded;
  - not to mandate access to digital services, would mean that a vital part of Australian communications infrastructure, a greater part of which is a public asset, will not be available to be used for the public good, that is, the availability of a diversity of services, which has been acknowledged by both the major parties as being highly desirable.

Efficient use of infrastructure

- Not declaring digital pay TV services while maintaining access for analogue pay TV services would encourage the continued use of analogue spectrum by access seekers, rather than the use of digital spectrum
  - as the capacity of the HFC cable is finite, the continued use of analogue spectrum by access seekers may prevent the full range of digital services being utilised. That would be contrary to the aim of encouraging efficient use of the infrastructure;
  - without access to digital services, the potential diversity of content on broadband services will be stifled because niche players would not have the opportunity of offering their content to a wider audience.

Why 'access holiday' not necessary – investment in infrastructure

- There is no evidence that the existence of the declaration powers under Part XIC has acted as a disincentive to investment in new infrastructure, or the upgrading or modification of existing infrastructure
  - at the time the Telstra HFC cable was laid it was the common policy of both the government and opposition parties to provide an open access regime to the cable after a limited exclusive period for the builders of the cable. Each of

Optus and Telstra made their investment decisions on that basis and on the assumption that the HFC cables would be used for digital technology in the medium term;

- accordingly, the bulk of the investment has already been made on the assumption by Telstra and Optus that the HFC cable would be subject to open access for digital pay TV;
- also, Telstra states that it is rolling out significant investments such as the CDMA mobile network and the ADSL service. Both of these are to be used for broadband services, one for mobile, the other for fixed services. Some services which have been declared can be provided via these new technologies. The potential for access to these services has not dissuaded Telstra from proceeding with their rollout;
- Optus is proceeding to digitise its cable network and has not been dissuaded in proceeding with this investment by the potential for access to digital being mandated. Indeed, Optus has made public statements to the effect that it does not support the concept of an 'access holiday' (see media 16 August 2001);
- the Chairman of the ACCC, Professor Allan Fels, has observed that Foxtel has exaggerated the commercial impediments to digitising the network;[57]
- the cost of digitisation claimed by Foxtel, of $500 million, is less than 25% of the $2 billion which News/PBL/Telstra have written off (in new technical ventures) over the past 18 months. The partners have also recently spent $750m on sporting rights, including Telstra sponsorships to create a monopoly for sporting rights on the cable. From the published financial statements of the partners it can be deduced that $500 million cost of digitising the cable represents:
- less that 4 weeks net cashflow of the partners; or
- less than 3 days turnover of the partners.

Telstra's assertion that an 'access holiday' is essential for investment in digitisation is contrary to overseas experience. For example, in Canada, the Canadian Radio-television and Telecommunications Commission (CRTC) has mandated an open access regime to content providers on the cable systems. This has not acted as a disincentive to the industry participants to digitise the HFC cables. Specifically, in the last 5 years the Canadian cable industry has invested more than $5 billion in infrastructure. This has been accomplished without providing any 'access holidays' to particular industry participants. At its recent conference in Toronto, the CCTA announced that cable companies in Canada continue to be strongly committed to rolling out digital services as demonstrated by significant investments and efforts to roll out digital services, packages, and digital terminals.

[57] See media reports 16 August 2001. See also a speech by Professor Fels "Collaboration and Competition: E-commerce, Foxtel Access and Mergers" 20 August 2001 (http://www.accc.gov.au/speeches/2001/Fels_Bus_Lead_20801.htm).