

Pay TV and Regional Telecommunications

**Submission by
FOXTEL
to the
Productivity Commission**



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EXECUTIVE SUMMARY

This is a submission by FOXTEL Management Pty Limited on behalf of the FOXTEL Partnership (**FOXTEL**) in response to the Productivity Commission's (the **Commission**) Issues Paper No. 2 on "Pay TV and Regional Telecommunications." The submission also responds to and comments on Chapter 16 of the Commission's Draft Report on Telecommunications Competition Regulation.

FOXTEL is a subscription television content provider. FOXTEL's predominant source of revenue is from subscription fees. The partners in the FOXTEL Partnership are Telstra Corporation Limited 50%, The News Corporation Limited 25% and Publishing and Broadcasting Limited 25%. FOXTEL operates its business independently of the businesses of the partners.

FOXTEL notes that the Commission's Draft Report recognises the existence of a "pay television market" and also recognises that both a regional pay television market and metropolitan pay television market exist in Australia. FOXTEL is of the view that the relevant retail market is the national television market. The use of the phrase "pay television market" in this submission is purely for the purpose of maintaining consistency with the Commission's terminology and does not in anyway suggest that FOXTEL accepts that this is the appropriate market.

The submission broadly follows the Commission's prompts for comments and is divided into the following sections:

1. The extent of exclusive supply arrangements for programming content in Australia and the alternatives;
2. The history of and rationale for these exclusive supply arrangements;
3. Ownership or vertical integration;
4. The effects of these exclusive arrangements, particularly on regional pay TV operators;
5. The effects of pay TV programming content exclusivity on competition in non-pay TV markets, particularly telephony and data markets;
6. The overseas experience; and
7. The case for further regulation of pay TV programming.

FOXTEL notes that whilst the Commission's inquiry is limited to programming content issues in regional areas, Optus has made a submission which goes beyond this and looks at issues in metropolitan areas. As this goes beyond the Commission's terms of reference, FOXTEL does not propose to deal with Optus' submission in detail but, where necessary or appropriate will comment on those issues.

Essentially, FOXTEL submits that it would be inappropriate for pay TV programming to face additional regulation for the following reasons:

- Exclusive supply arrangements for programming content in Australia are limited and there is alternative programming available to regional and metropolitan pay TV operators. These programming alternatives include cartoons, news, series, sport, general entertainment, documentaries and, to some extent, movies. Much of this programming is not currently broadcast as part of any pay television line up available in Australia.
- There are a number of reasons why pay TV providers in regional areas may face difficulties in establishing services which have nothing to do with these exclusive arrangements eg, small size of the market and low population density, potential lack of demand, high cost of

programming and high capital expenditure costs, long periods to recover the full costs of customer acquisition and installation and the devaluation of the Australian dollar.

- Exclusive supply arrangements are actually pro-competitive as they increase consumer choice and provide a means of differentiation and therefore competition between pay TV operators. Providing open access would not increase the choice available to consumers but would in fact limit diversity by increasing the likelihood that pay TV providers would have the same or substantially similar programming line ups.
- Exclusive programming supply contracts are commercially justifiable and are not used to foreclose competition in pay TV or related markets. These types of programming arrangements are particularly important in metropolitan areas where there is substantial overbuild of cable networks, as it enables pay TV providers to differentiate their services. These kinds of arrangements are also typical within the free-to-air environment. Differentiation allows providers to build brand which is central to their ability to be viable in the long term as it increases the likelihood of recovery of past investments and further investment and innovation. No pay TV operator in Australia has yet made a recovery on its investment despite a number of operators having been established for at least five years.
- Further, open access to programming would mean that a business can no longer be merely a pay TV content provider but will need to have the ability to bundle other telecommunications products to be able to successfully compete. The only other way a pay television content provider could distinguish itself from its competitors is via its price to the consumer in an environment where no pay TV operator has made a return on its investment. The introduction of an open access programming regime will severely disadvantage FOXTEL which is not able to bundle its services and which has established its business on the basis that these exclusive arrangements are permitted.
- The competition in metropolitan areas faced by pay TV operators is substantial. In addition to competition from other pay TV providers, there is competition from free-to-air broadcasters, Internet, cinema and videos. It is also unclear how the pay TV industry will be affected by new technologies such as digital multi-channelling by the free-to-air, video streaming over the Internet or video on demand. Further regulation of the industry at this stage may in fact hinder the ability of pay TV providers to recover their costs and even make a reasonable return on investment. It may also force pay TV providers to alter current strategies to the detriment of consumers eg. requiring the consumer to rent or purchase the set top unit. None of these other competing content service providers face open access to their programming: it would be absurd, for example, if Channel Nine was forced to give access to the “Friends” or “Sixty Minutes” program to Channel Seven or the ABC.
- Whilst pay TV may be bundled with telephony and Internet, bundling is not currently necessary to the success of either of those products as is evidenced by the numbers of providers who do not bundle pay TV with their services. In regional areas in particular, the necessary revenue for investment could come from other services such as data and Internet services.
- Whilst there is some level of vertical integration between program suppliers and providers in Australia, this is minimal (compared, for example, to the situation in the US) and the long term supply agreements are commercial arrangements at arm’s length.
- The UK and US situations can be distinguished from Australia. The pay TV industry in Australia is still immature and has significantly lower penetration rates than the UK and US. New providers, particularly in regional areas, are still emerging. In addition, the size of the market is much smaller than that of the UK or the US, competition from free-to-air is

more intense and the extent of vertical integration, as compared to the US, is much lower. US pay TV companies are making substantial profits, unlike Australian pay TV operators who are yet to make reasonable returns on their investment.

- The US market, in particular, is unique in that it developed with local cable television providers who developed geographic monopolies, which encouraged strong affiliations between program suppliers and cable operators and contributed to the high level of vertical integration and the number of exclusive content supply arrangements in the US. The same is not evidenced in Australia. As such, an access regime, similar to that implemented in the US, is not appropriate for the Australian market.
- There is recognition by some of the overseas authorities that exclusive programming can be pro-competitive, rather than anti-competitive.
- Imposing a programming access regime would be an unnecessary and inappropriate interference with the economic rights of program suppliers and providers. Programming supply arrangements and facilities based competition can be adequately dealt with under the current Part IV and Part XIC regimes in the Trade Practices Act 1974 (the *TPA*) and should not be singled out for more stringent regulation than other services when no real basis for such regulation has been demonstrated.
- Ultimately, FOXTEL agrees with the Commission's suggestion that, at this stage, there should be no additional regulation of pay TV programming arrangements. However, FOXTEL has no objection if the Commission wishes to monitor the development of regional pay TV and other services and the effect of exclusive content arrangements on these markets and would be willing to co-operate with the Commission in this regard.

1. Extent of exclusive programming arrangements in Australia

The Commission in its Issues Paper asked for information on the current arrangements for obtaining programming for pay TV services and what alternatives there are¹. In its Draft Report, the Commission has also requested feedback about the degree of exclusive contracting for content².

We outline in this section some of the arrangements that exist in relation to the supply in Australia of pay TV programming content and the alternatives for the supply of content in Australia. The former is also summarised in the table contained in Schedule 1.

(a) Movies

The following wholesale suppliers of movie channels currently distribute their channels in Australia:

- **Premium Movie Partnership (*PMP*)** is a consortium of the Hollywood studios Columbia Tristar (Sony), Paramount, Universal and Twentieth Century Fox as well as Liberty Media which produces the channels *Showtime* (new release movies), *Showtime 2* (a multiplex of Showtime) and *Encore* (classic movies). FOXTEL holds exclusive distribution rights for these channels in Australia and sublicenses them to Austar and Neighborhood Cable.
- **Movie Networks** is a consortium of the Hollywood studios Disney, Warner Brothers and MGM and the Australian distributor Roadshow which produces the channels *Movie One* (new release movies), *Movie Extra* (made-for-television miniseries and movies) and *Movie Greats* (all time favourites). Movie Networks used to be exclusively licensed to Optus in Australia, but is now licensed to Optus and Austar on a non-exclusive basis.
- **Turner Broadcasting System Asia Pacific Inc.**, licences on a non-exclusive basis the *TCM* channel (which contains pre-1986 MGM movies) to FOXTEL, Optus, Austar, Neighborhood Cable and TARBS.
- **Pan TV** is a single-channel supplier of the foreign language movie channel *World Movies* which is licensed in Australia to FOXTEL on a non-exclusive basis and is also licensed to Optus and Austar.

(b) Sports

The following wholesale suppliers of sports channels currently distribute their channels in Australia:

- **C7**, a subsidiary of the Seven Network, licences the channel *C7 Sport* non-exclusively to Austar, Optus, Neighborhood Cable and Access 1. The channel contains a number of sports including AFL (2001 season), soccer (national soccer league), rugby union, world championship wrestling, surfing, golf, equestrian, triathlon, tennis and domestic cricket.
- **FOX Sports**, a 50/50 joint venture between News Limited and PBL, licences the channels *FOX Sports* and *FOX Sports 2* to Austar and Austar sublicenses the

¹ Productivity Commission, Review of Telecommunications Specific Competition Regulation: additional matters under reference – Issues Paper 2, January 2001 at 10.

² Productivity Commission, *Telecommunications Competition Regulation*, Draft Report, March 2001 at 16.15.

channels to FOXTEL. The channel contains a number of sports including NRL, cricket, golf, athletics, tennis and English soccer. Fox Sports also licences the channel *NRL on Optus* to Optus. The FOX Sports channels are available for distribution on the Optus network.³

- **ESPN Inc**, licences the international sports channels *ESPN* and / or *ESPN2* in Australia to Optus, Austar, Neighborhood Cable, TARBS and TPG Boomerang. The channels contain a number of sports including motor sports, tennis, golf, cricket, soccer and basketball.
- **Sky Channel**, a single-channel supplier of a racing channel known as *Sky Racing*, which is licensed on a non-exclusive basis to FOXTEL, and is also licensed to Optus, Austar, TARBS and Neighbourhood Cable.

(c) General Entertainment

The following wholesale suppliers of general entertainment channels currently distribute channels in Australia:

- **XYZ Entertainment**, a 50/50 joint venture between FOXTEL and Austar produces and distributes to FOXTEL and Austar the *Lifestyle* and *arena* channels.
- **FOXTEL**, produces and distributes the channels *FOX 8* and *fX* on FOXTEL and licenses the channels to Austar.
- **Crown Media International Inc.**, is a single-channel supplier of the *Hallmark channel* which consists of telemovies and miniseries and which is licensed in Australia to FOXTEL, Austar and Neighborhood Cable.
- **TV1** (70's and 80's) is a consortium of the Hollywood studios, Columbia Tristar (Sony), Paramount and Universal. FOXTEL holds exclusive distribution rights for the *TV1* channel in Australia and licenses the channel to Austar.
- **thecomedychannel**, is a 80/20 joint venture between Artist Services and FOXTEL which produces and distributes *thecomedychannel* to FOXTEL and Austar.
- **UKTV**, is a joint venture between Pearson, BBC World and FOXTEL which produces and supplies a single-channel known as *UKTV* consisting primarily of British television shows which is licensed to FOXTEL in Australia and FOXTEL sublicenses the channel to Austar.

(d) News/weather/finance

The following wholesale suppliers of news, weather and finance channels currently distribute channels in Australia:

- **The Australian News Channel** is a 3-way partnership between BSkyB, the Nine Network and the Seven Network which produces the *Sky News Australia* channel which is distributed non-exclusively in Australia to FOXTEL and is also licensed to Optus, Austar and Neighborhood Cable.
- **FOX News Network** licenses a US news channel known as *FOX News* exclusively to FOXTEL in Australia.

³ Fox Sports, *Additional Submission to Telecommunications Inquiry in response to Productivity Commission's Draft Report – Review of Telecommunications Competition Regulation*, May 2001.

- **Turner Broadcasting System Asia Pacific Inc** distributes the channel *CNN International* non-exclusively in Australia to FOXTEL and also licences the channel to Optus, Austar, Neighborhood Cable, TARBS and TPG Boomerang. Turner also distributes *CNN Finance* in Australia to TPG Boomerang and Optus.
- **CNBC Asia** distributes the channel *CNBC Australia*, an Asian region news channel in Australia to FOXTEL, Austar, Optus, Neighborhood Cable and Transact.
- **BBC Worldwide** distributes the *BBC World* news channel in Australia to Neighborhood Cable, Optus, Transact and FOXTEL.
- **Bloomberg Television** distributes a finance channel known as Bloomberg to FOXTEL, Access 1, Austar and Neighborhood Cable.
- **Various weather channels:** *The Weather Channel* is owned 100% by Austar and is distributed in Australia by Austar. *Weather Vision* is distributed in Australia by Optus and *FOXTEL Weather* is distributed in Australia by FOXTEL.

(e) Childrens

The following wholesale suppliers of childrens channels currently distribute channels in Australia:

- **XYZ Entertainment**, a 50/50 joint venture between FOXTEL and Austar which distributes to FOXTEL and Austar the *Nickelodeon Australia* channel produced by Nickelodeon Australia, a joint venture between XYZ and Nickelodeon US.
- **Turner Broadcasting System Asia Pacific Inc.**, distributes the *Cartoon Network* non-exclusively to FOXTEL and also licences the channel to Austar, Optus, Neighborhood Cable and TARBS.
- **Buena Vista**, which supplies the *Disney Channel* in Australia to Optus, Austar, Neighborhood Cable and Transact.
- **FOXTEL**, which produces and broadcasts the *FOX Kids* service in Australia.

(f) Music

The following wholesale suppliers of music channels currently distribute channels in Australia:

- **XYZ Entertainment**, a 50/50 joint venture between FOXTEL and Austar produces and distributes to FOXTEL and Austar *Channel [V]* and *MusicMax*.
- **Country Music Television** supplies the channel *Music Country* in Australia, to FOXTEL, Optus, Austar and Neighborhood Cable.
- **MTV** supplies the *MTV* channel to Optus in Australia.

(g) Documentaries and History

The following wholesale suppliers of documentary and history channels currently distribute channels in Australia:

- **XYZ Entertainment**, a 50/50 joint venture between FOXTEL and Austar distributes to FOXTEL and Austar the *Discovery channel*.
- **Animal Planet** is produced by a joint venture between Discovery Communications Inc. and BBC and is licensed in Australia to Optus, Neighborhood Cable and TPG Boomerang.

- **AETN** supplies *The History Channel* exclusively to FOXTEL.
- **National Geographic Australia** is a partnership between BSkyB and NGC Network (UK) Limited and supplies the *National Geographic Channel* to FOXTEL, Austar, Optus and Neighborhood Cable.

(h) Others

The following wholesaler suppliers of pay television channels currently distribute channels in Australia:

- **TVSN**, a shopping channel, which is licensed in Australia to FOXTEL, Optus, Austar and Neighborhood Cable. Austar owns 51% of TVSN limited.³
- **Main Event**, a joint venture between FOXTEL, Austar and Optus produces and licenses the channels *Adults Only* (adult entertainment) and *Main Event* (pay per view events) to FOXTEL, Austar and Optus.
- **TARBS** produces and distributes the *Nightmoves* channel (adult movies) in Australia.
- **Various foreign language channels** (including *Antenna Pacific*, *RAI International*, *NHK*, *Mega Cosmos*, *Alpha Gatl*, *Tagalog*, *TVB3*, *CCTV*, *ART* and *LBC*) are each distributed in Australia on various platforms including Optus, FOXTEL, Neighborhood Cable and TARBS. FOXTEL currently licenses *RAI International* and *Antenna Pacific*.
- **Fashion TV** is supplied by FTV (BVI) Ltd to FOXTEL and Neighborhood Cable.

FOXTEL therefore submits that the extent of pure exclusive supply arrangements in Australia is limited, more so than overseas (as is discussed later in this submission) and that the licensed operator or distributor of the program may, in certain circumstances, sub-license the program to another provider.

FOXTEL also submits there is an abundance of programming available for distribution within Australia. Some of this programming is currently supplied non-exclusively in Australia (as detailed above) or is capable of being sourced from within Australia. There is also a significant amount of programming content available overseas which is not currently supplied in Australia. FOXTEL is currently aware of at least 40 other potential channels that are capable of being accessed by pay television providers in Australia. The table below illustrates the extent of potential programming that could possibly be sourced from overseas operators (subject to rights clearances) and illustrates how few pay television channels are actually being broadcast as part of the current pay television line-ups in Australia.

³ Austar United Communications, *Annual Report*, 2000.

OPERATOR	CHANNELS
FOXTEL	44 (including 5 retransmitted free-to-air)
BSkyB (UK)	201 (including 13 FTA, 72 PPV screens (channels), 10 digital audio and 27 radio)
DirecTV (US satellite)	376 (including approx. 7 FTA, 99 PPV screens (channels) and 31 audio)
Echostar (US satellite)	318 (including approx. 6 FTA, 31 PPV screens (channels) and 63 audio)
Comcast (digital cable)	267 (including approx. 15 FTA, 44 PPV screens (channels) and 40 audio)

Source: Company publications and FOXTEL estimates.

FOXTEL believes that it is more important to encourage diversity of programming content available to subscribers by pay TV providers acquiring new content rather than replicating existing content.

2. Reasons for pay TV programming exclusivity

2.1 Exclusivity necessary for differentiation

The Commission has requested feedback on the reasons for the existence of exclusive pay TV programming content supply arrangements in Australia⁴.

FOXTEL submits that the existence of pay TV exclusivity, is pro-competitive. Exclusive program content arrangements promote diversity and differentiation between pay TV providers. Exclusivity is a crucial area of competition between pay TV providers, particularly in metropolitan areas where there is a substantial degree of overbuild with the Telstra and Optus cable networks overbuilt by approximately 80% in the main metropolitan areas⁵.

Exclusivity enables pay TV providers to promote a particular channel without promoting a competitor, which is essential to the creation and promotion of their brand. With exclusive programming arrangements, consumers are offered more choice and diversity of programming, rather than duplication. Without diversity of programming and the ability of pay TV providers to market themselves on the basis of “exclusive” programming, the only basis upon which pay TV operators would be able to compete is price. This is particularly problematic in the current environment where retail prices are already low as a result of the competitive pressures already exerted on pay TV providers from free-to-air, videos, cinemas and on-line services and where no pay TV provider has yet made a return on its investment.

Differentiation allows pay TV providers to build brand equity, which is critical to viability in the long term and in turn allows them to generate the revenues that enable them to invest and innovate. This is particularly the case where a pay TV provider relies solely upon revenue from its programming.

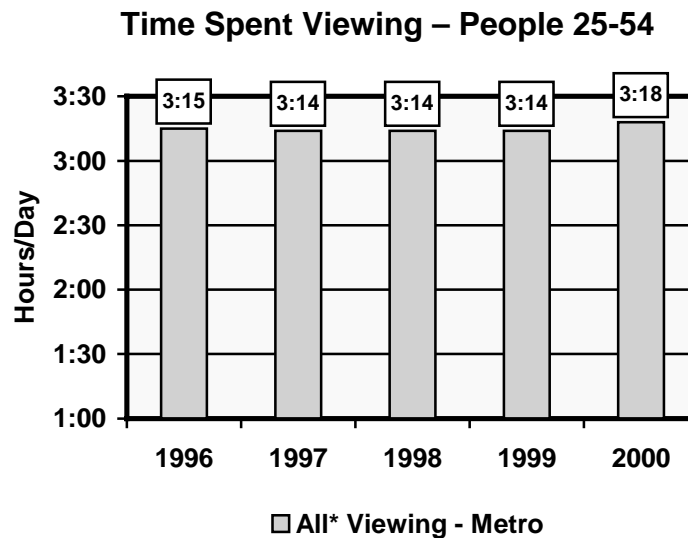
Taking away exclusivity would also undermine the investments made to date by pay TV providers and impede their ability to recover their costs while also acting as a disincentive to further investment. No pay TV operator in Australia has yet made a return on their investment and each of FOXTEL, Austar and Optus Television are in fact still making substantial losses despite having been operating since 1995. This is primarily due to the characteristics of the pay TV business - high programming costs and high capital expenditure costs, long lead times for recovery of full customer acquisition and installation costs, the high level of regulation and the devaluation of the Australian dollar which all contribute to making it a high cost industry.

Differentiation is particularly important given that FOXTEL is competing with many other means of distributing very similar video product, which include not only Optus and other pay TV providers but free-to-air television, cinema, video rentals and sales and the Internet. These services are competing for the same audiences and advertisers, and in some instances, in the same home and on the same television set (see Table 2.1). In the future, FOXTEL is likely to face additional competition from video streaming over the Internet, digital multi-channelling by the free-to-air and video on demand.

⁴ Productivity Commission, *Telecommunications Competition Regulation*, Draft Report, March 2001 at 16.15.

⁵ Veljanovski, Cento, *Pay TV in Australia: Markets and Mergers*, Institute of Public Affairs 1999 at 21.

Table 2.1



Source: ACNielsen Metro Media Advisor – Total People Weeks 1-52 Viewing/Demo
 *ALL viewing is defined as 2, 7, 9, 10, SBS, Spill-in, Community, Pay TV

In addition, the different windows given to the release of movies means that cinemas and videos have an advantage over pay TV providers in relation to movies; similarly, the anti-siphoning laws give free-to-air broadcasters an advantage in relation to sporting events. It is important for pay TV providers to be able to differentiate their service not just from each other but also from these other substitutable services. FOXTEL notes that none of these other content service providers face open access to their programming despite the prevalence of exclusive arrangements in those industries.

Free-to-air television is a perfect example of exclusive programming content creating an important and recognised basis for differentiation and brand building. It would be absurd if Channel 9 was forced to give access to the “Friends” program to Channel 7 or the ABC and no-one would contemplate imposing any such regulation on the free-to-air providers despite the fact that Channel 9’s ability to exclusively licence such programs gives it an edge over its competitors and increases its potential to earn advertising revenue.

There is also no requirement for the free-to-air broadcasters to licence their general entertainment products to pay TV providers even though this may increase the likelihood of pay TV providers making a reasonable recovery from their investment. In fact, the free-to-air providers can and do “hoard” the pay TV rights to show general entertainment programs.

These exclusive arrangements also arise from the preferences of some channel suppliers who prefer dealing with a single pay TV provider in Australia as the market is extremely small in comparison with the US, UK and European markets. Accordingly, it is more convenient for the suppliers to enter into a single arrangement requiring high minimum subscriber guarantees from that provider. This rationale on the part of suppliers is not anti-competitive in nature but is simply a commercial decision on the basis that it is more cost-effective for them to do business this way.

FOXTEL submits that the current pay TV programming exclusive supply arrangements are entirely justifiable on a commercial basis and are not used, as is suggested by the

ACCC and Optus, to foreclose competition or drive out competitors⁶. Product differentiation is a natural area of healthy competition, as the Commission itself recognises⁷.

2.2 History of exclusivity

Given the comments of Optus about a “dominant” pay TV provider having an incentive to enter into exclusive content supply arrangements⁸, it is important for the Commission to understand the history of these exclusive arrangements, particularly as regards movies, in Australia.

In 1995, when pay TV was finally introduced in Australia, exclusive programming was recognised as the only way in which the start-up pay TV providers could build brand and attract subscribers in the emerging pay TV industry. Many of these arrangements were entered into before pay TV providers commenced operations.

The first pay TV providers, Optus Vision and Australis, both secured exclusive rights to movies from the major US movie networks Optus Vision with Disney, Time Warner and MGM (the Movie Networks) and Australis with Columbia, Paramount, Universal and, later, Twentieth Century Fox (the Premium Movie Partnership or PMP). When FOXTEL commenced its service in October 1995, it was forced to sub-licence the PMP movies from Australis at an unsustainably high price. When Australis collapsed in 1998, FOXTEL was then able to take over the arrangement directly with PMP.

The minimum subscriber numbers required by the movie networks on launch of pay TV meant that it was necessary to appeal to and attract large numbers of subscribers which could only be done on the basis of exclusive programming. In addition, it was necessary to attract these subscribers to recover the large initial investment in the infrastructure necessary to provide pay TV.

Competition was initially also driven by the fact that the cable roll-out of FOXTEL and Optus Vision was largely overbuilt, that is to say, approximately 80% of homes passed by one cable in metropolitan areas are also passed by the other cable⁹. Such an overbuild from the launch of the service is unique. This duplication was at the time supported by the Federal Government who believed that duplication would create competition.

It was also necessary to enter into exclusive arrangements for sporting events not on the anti-siphoning list. Because so much popular sport is on the anti-siphoning list and available live and exclusive on free-to-air television, the different pay TV providers entered into exclusive arrangements to differentiate their sport offerings. As with movies, Optus was amongst the first pay TV operators to enter into exclusive arrangements in relation to sport with SportsVision which held the pay television rights to both the AFL and ARL.

Optus and FOXTEL initially competed heavily on price and brand with Optus having in excess of the number of FOXTEL subscribers in late 1996 and early 1997. During this period Optus continued to hold exclusive rights to certain channels. By mid 1997 the

⁶ Australian Competition and Consumer Commission, *Submission to the Telecommunications Service Inquiry (Besley Inquiry)*, 2001 Part 2 and Supporting Papers at p4; Cable and Wireless Optus, *Submission to the Productivity Commission’s “Review of Telecommunications Specific Competition Regulation: additional matters under reference”* 2001 at 3.

⁷ Productivity Commission, *Telecommunications Competition Regulation*, Draft Report, March 2001 at 16.15.

⁸ Cable and Wireless Optus, *Submission to the Productivity Commission’s “Review of Telecommunications Specific Competition Regulation: additional matters under reference”* 2001 at 3.

⁹ Veljanovski, Cento, *Pay TV in Australia: Markets and Mergers*, Institute of Public Affairs 1999 at 21.

number of Optus subscribers began to plateau. However, FOXTEL submits that this plateau was unrelated to access or lack of access to exclusive programming arrangements but due to a series of events which are discussed in more detail below.

2.3 Current arrangements

The assertion by Optus that a “dominant” pay TV provider has incentives to enter into exclusive arrangements to foreclose competition is therefore not correct and is not borne out by the history of pay TV content exclusivity in Australia. Exclusive arrangements were entered into at a time when no one pay TV operator was “dominant”. Indeed, Optus was one of the first operators in Australia to seek out exclusive arrangements.

On 16 June 1999, Optus announced that it had renegotiated its arrangement with its major Hollywood studios which resulted in “reductions of nearly 40% in the minimum subscriber guarantee payments to the studios” which was “worth approximately \$250 million to the company”.¹⁰

This renegotiation meant that the Movie Network studios were now able to supply content to other operators. However, the “content could only be made available if the other operators in turn made their content available to Optus on comparable terms”¹¹. While Optus argued that this constituted “a move to a more rational structure for the industry”¹², FOXTEL submits that this shows the value that Optus in fact places on exclusivity as FOXTEL is not permitted to be supplied with the Movie Network channels unless FOXTEL is willing to forego its exclusivity rights to the PMP movie channels¹³. Contrary to Optus’ submissions, the principal reasons why FOXTEL has not taken the Movie Network channels to date is first, because of the cost of licensing those channels, and second, because of the value FOXTEL places on being able to differentiate its programming line-up from that of its competitors. FOXTEL is simply acting in its own commercial interests in not taking those channels and is similarly acting in its own commercial interests, not for any anti-competitive reasons, in maintaining its exclusive arrangement with PMP.

In essence, Optus wants FOXTEL to bear all the costs and risks associated with establishing and marketing channels before Optus commits to them. For example, Optus has also complained that it cannot obtain access to the TV1 channel which shows successful retro TV services. FOXTEL entered into an exclusive distribution arrangement with the TV1 Partnership after the Australis demise¹⁴, paying a premium for this exclusivity, to be able to specifically market this channel and differentiate its line up. Optus now wants access to this channel as it has proven, through FOXTEL’s marketing, to be a popular and successful channel. There is nothing preventing Optus or anyone else setting up a channel to compete with TV1 as TV1 broadcasts only a small percentage the competing product available for exploitation in Australia.

This exposes Optus’ real agenda: to save costs and avoid risks by “cherry picking” the successful channels or programs from FOXTEL’s line-up. This is clearly not in the interests of consumers. On the contrary, it would be in the best interests of consumers

¹⁰ Cable and Wireless Optus, Media Release, “Cable & Wireless Optus secures new deal on movies”, 16 June 1999.

¹¹ Ibid.

¹² Ibid.

¹³ Ibid and Cable and Wireless Optus, *Submission to the Productivity Commission’s “Review of Telecommunications Specific Competition Regulation: additional matters under reference”* 2001 at para 2.24.

¹⁴ FOXTEL sublicenses the TVI Channel to Austar.

for Optus and other pay TV providers to be encouraged to produce new channels rather than simply duplicating the existing available content.

In relation to sport, News Ltd not FOXTEL acquired from the AFL the exclusive pay TV rights. This competition between News Ltd and C7 for the AFL rights is clearly competitive. FOXTEL has acquired the pay TV rights from News Limited and has publicly stated that “FOXTEL will make its AFL coverage available to all pay TV homes across Australia by offering it non-exclusively to other pay TV platforms”¹⁵. Accordingly, potentially all pay TV subscribers will have access to the AFL pay TV programming, which is the Commission’s primary concern.

Optus also criticises FOXTEL for refusing to licence the C7 channel and uses this as an example of anti-competitive behaviour on FOXTEL’s part. Optus asserts that the reason why FOXTEL did not agree to carry the C7 channel was “to establish itself as the monopoly buyer of high-quality content in Australia over the longer term”¹⁶. FOXTEL refused to license the C7 channel because the content shown on that channel was not regarded as being attractive enough to subscribers and the price C7 was asking was too high. C7’s coverage of the AFL has been generally poor with games often delayed on C7 (by up to 46 hours) to allow first broadcast by Channel Seven. FOXTEL assumes that this indicates the conflict encountered by the Seven Network (being C7’s parent) in preserving its free-to-air ratings as against developing and producing an attractive pay TV channel.

In terms of the NRL, FOX Sports, not FOXTEL, acquired the rights to the NRL and licences the channels Fox Sports 1 and Fox Sports 2 to Austar. Austar sub-licences the channels to FOXTEL. FOX Sports has also agreed to supply the NRL to Optus. FOXTEL cannot comment on the “packaging conditions” imposed by FOX Sports in conjunction with this supply.

There are a number of reasons why a pay TV provider may choose not to license the rights to channels offered to it and this is ultimately a commercial decision for the pay TV provider. The decision to license or produce a channel is not made without significant consideration particularly in view of the high associated costs and the limited carriage capacity available to most pay TV providers. FOXTEL rejects channel offers regularly for various reasons as it is entitled to do and submits that these arrangements should not be interfered with unless they involve some misuse of market power or substantial lessening of competition.

¹⁵ FOXTEL, Media Release “FOXTEL to Televisé the Australian Football League”, 19 December 2000.

¹⁶ Cable and Wireless Optus, *Submission to the Productivity Commission’s “Review of Telecommunications Specific Competition Regulation: additional matters under reference”* 2001 at para 2.19.

3. Cross-ownership and vertical integration

3.1 Cross-ownership between pay TV provider and program supplier

The Commission has also raised the issue of cross-ownership and how this affects program supply arrangements in Australia¹⁷.

The distant relationship between FOXTEL and PMP has no relevance to the exclusive content supply relationship between FOXTEL and PMP, which is an arm's length dealing. As discussed above, it was in fact Australis that first entered into an exclusive supply relationship with PMP and FOXTEL had no involvement in setting up that initial arrangement.

Even where there is traditional exclusivity in the form of common ownership, this is generally because the pay TV provider is investing in the programming being produced by the vertically integrated programming supplier and needs the exclusive rights to the product to build brand equity and assist in recouping its investment and production costs. Production companies will also typically try to share the start-up risk of new channels by getting pay TV companies to invest in the channel eg. *UKTV* which is a joint venture between FOXTEL, BBC World and Pearson and *thecomedychannel* which started as a joint venture between FOXTEL, Galaxy and Artist Services¹⁸. This is not anti-competitive but pro-competitive as it encourages pay TV providers to invest in the production of more programs and channels, ensures the quality of such programming and allows for a faster and easier launch time. In some cases, channels may not have been launched without a pay TV company's investment. Ultimately, it increases the choice to subscribers of quality pay TV. This incentive would be greatly reduced if supply was not exclusive.

Joint venture content production arrangements done through a consortium or joint venture of a number of pay TV providers such as XYZ Entertainment and Main Event Television (which produces two niche channels), are clearly pro-competitive and pro-consumer choice. Programming costs are high and pay TV providers should be encouraged to invest in producing programs. The producers of such programs should be free to make commercial decisions based on commercial imperatives without any additional regulatory interference.

Further, long-term exclusive arrangements are not a sign of vertical integration nor present the sorts of competitive problems that the traditional form of vertical integration, through ownership, may sometimes present. The program supplier simply wants to ensure the best price for its product for as long as possible, and the price for exclusivity is high. It also imposes high minimum subscriber guarantees to ensure that it obtains the revenue it wants from the exclusive licensee.

3.2 Cross-ownership between Pay TV provider and infrastructure owner

The Commission also refers to cross-ownership or vertical integration between the pay TV providers and cable owners and the problems of pay TV providers making

¹⁷ Productivity Commission, *Telecommunications Competition Regulation*, Draft Report, March 2001 at 16.4.

¹⁸ FOXTEL bought Galaxy's interest when it became insolvent.

arrangements for transporting content to networks from programming houses²⁰. Optus in its submission also places much weight on this perceived vertical integration, particularly as regards the FOXTEL service being distributed via the Telstra broadband cable, consistently referring, incorrectly, to the “FOXTEL cable”²¹.

As the Commission would be aware, FOXTEL is owned 50% by Telstra Corporation Limited, 25% by The News Corporation Limited and 25% by Publishing and Broadcasting Limited. FOXTEL is not controlled by Telstra, and its non-Telstra partners have different interests from that of Telstra. The arrangement between FOXTEL and Telstra as to FOXTEL’s use of the broadband cable is a separate arrangement at arm’s length.

The relationship between FOXTEL and Telstra does not impact on programming arrangements. Further, it does not impact at all on access by other pay TV providers to distribution mechanisms for transporting the content to them.

There are a number of delivery options available to Australian pay TV providers. One option is for pay TV providers to receive programs by tape which are then compiled and replayed at a later time. FOXTEL does this in the case of Hallmark, Showtime, Encore, Fox8, fX and Fox Kids.

Alternatively, channels can be taken directly off satellite via a downlink. This feed can be broadcast immediately to subscribers or taped and broadcast on delay. This is the way in which Neighborhood Cable is able to obtain its channels and also how FOXTEL, Optus, Austar and TARBS obtain a number of their channels. There are a number of satellites with footprints over Australia including Asiasat 2, Pas 8, Asiasat 3S, Optus B1 and B3, Pas 2 and Intelsat. FOXTEL is aware of the existence of carriage capacity on a number of these satellites. Examples of channels available via satellite include the Disney Channel, Antenna Pacific, ART, LBC, BBC World, Bloomberg, Fashion TV, TCM, Cartoon Network, , CMT, CNBC, Animal Plant, ESPN, CNN and CNNfn. In some cases it may be necessary to arrange carriage on two satellites to enable a channel signal to be viewed in Australia. Examples of these types of channels include RAI International and Antenna Pacific which are delivered to Australian subscribers courtesy of two satellites. In addition, Southern Cross cable network now offers Transatlantic broadcast carriage services to third parties.¹²

Accordingly, FOXTEL submits that there is no bottleneck in relation to distribution mechanisms for transporting content.

²⁰ Productivity Commission, *Telecommunications Competition Regulation*, Draft Report, March 2001 at 16.4.

²¹ Cable and Wireless Optus, Submission to the Productivity Commission’s “Review of Telecommunications Specific Competition Regulation: additional matters under reference” 2001 at para 3.2.

¹² Southern Cross Cable Network website: <http://www.southerncrosscables.com>.

4. Effect of arrangements on regional pay TV

Regional subscribers currently have access to more comprehensive pay TV services than metropolitan areas via Austar (which carries many of the channels of both FOXTEL and Optus).

As discussed above, FOXTEL also submits that there is significant additional non-exclusive programming available to metropolitan and regional pay TV providers which is not yet accessed in Australia.

Small regional operators have established pay TV services on the basis of this available programming and also by sub-licensing some exclusive programming from the Australian licensee.

FOXTEL submits that a number of options are open to a regional provider:

- (i) It could establish its own pay TV service on the basis of the non-exclusive programming that is available.
- (ii) It could negotiate with an exclusive program licensee to sub-licence those rights if the licensee is willing to do so. If the exclusive rights holder has no plans to provide a service in a regional area, then it may be prepared to sub-licence its exclusive rights to an operator in this area. An example of this is the sub-licence by FOXTEL of the movie channels *Showtime* and *Encore* to Neighborhood Cable. This should be a matter for negotiation between the exclusive rights holder and the regional provider and not mandated by an access regime. If the exclusive arrangement is not otherwise unlawful under Part IV of the TPA, then the commercial rights of the exclusive licensee should not be interfered with.
- (iii) It could negotiate with the licensee for the licensee to provide that licensee's pay TV branded service for distribution on the relevant network (this would appeal to infrastructure owners looking for a return on investment who do not necessarily want to supply their own retail pay TV service).

FOXTEL is aware of the following cable operators who are rolling out or have rolled-out regional cable networks for the delivery of broadband pay TV services:

- **Neighbourhood Cable** has now rolled out a cable network passed 8,200 homes in Mildura²², 28,000 homes in Ballarat²³ and plans to roll-out in Bendigo, Geelong, Shepparton and Albury-Wodonga²⁴. It expects to eventually pass "a quarter of a million homes by the end of next year" and currently has about 1350 subscribers²⁴. Neighbourhood Cable currently offers the following programming on its Mildura cable service: TVSN, Disney Channel, Sky News Australia, Imparja, CNN, BBC News, Sky Racing, Animal Plant, MCM, Music Country, Cartoon Network, National Geographic Channel, ESPN, ESPN 2, C7 Sport, Fashion TV, Deutsche Welle German, Rai Italian TV, Lashkara Indian TV, Antenna Greek TV, TRT Turkish TV, TCM Classic Movies, Hallmark, EWTN Catholic Network, CNBC, Bloomberg Television, Showtime and Encore. Neighborhood Cable also offers Internet dial-up and cable modem services.

²² Australian Stock Exchange, Document Number 233774, 24 April 2001.

²³ Adamas, David, "Neighbourhood Cable moves down the road" *The Age* 17 April 2001.

²⁴ Ibid.

- **TransACT** has begun to roll-out its fibre-optic cable network in Canberra. The network currently passes 7,000 homes and aims to pass 24,000 in June, 64,000 in December and eventually 100,000 mid-next year²⁵. The company was launched in May 2000 and already has approximately 100 subscribers²⁶.

Connection to TransACT costs \$20 a month, for which the subscriber gets a set-top box, a mobile phone, the option to create a high speed Internet account, the option of competitive broadband telephony, the digital free-to-air channels and a number of bonus incentive channels²⁷.

The channels that are offered include CNBC Asia, the Disney Channel, BBC World, the Parliamentary Channel and a number of foreign language services²⁸.

TransACT also plans to launch a video on demand service in conjunction with Total TV, charging customers an additional fee per video²⁹. The videos become available as soon as they are released to video stores and initially it will have a library of 100 videos, with the potential to expand to thousands of titles³⁰.

The roll-out so far has cost TransACT \$90,000,000 and is expected to cost another \$90,000,000³¹. Fifteen to twenty percent of its total revenue is expected to come from video-on-demand³². The Chief Executive of TransACT has stated that although they could be a stand-alone pay TV service provider they have simply chosen not to be³³.

In addition FOXTEL is aware of the following satellite operators that offer services in regional areas:

- **Austar**, has approximately 421,000 subscribers³⁴ in the Northern Territory and Tasmania and the regional areas of Queensland including the Gold Coast, NSW, South Australia and Victoria³⁵ via its satellite, cable and MDS service. Austar, offers the following programming: TV1, Arena, The Lifestyle Channel, thecomedychannel, fX, UKTV, FOX8, Discovery Channel, National Geographic Channel, Nickelodeon, Disney Channel, Cartoon Network, TVSN, Fox Sports, Fox Sports 2, Sky Racing, C7 Sport, ESPN, Adults Only, Main Event, Channel V, MusicMax, Music Country, Sky News Australia, The Weather Channel, CNN, CNBC, Bloomberg Television, Hallmark, Movie One, Movie Extra, Movie Greats, Showtime, Encore and World Movies. Austar also offers interactive television, narrowband dial-up Internet and mobile telephony resale.

²⁵ Mckelvey, Ben, "World-beating TransACT rolls out open platform" *Media Day*, 14 March 2001.

²⁶ Ibid.

²⁷ Ibid.

²⁸ Ibid.

²⁹ Manktelow, Nicole, "ACT debuts video on demand" *Sydney Morning Herald*, 13 March 2001.

³⁰ Manktelow, Nicole, "ACT debuts video on demand" *Sydney Morning Herald*, 13 March 2001.

³¹ Mckelvey, Ben, "World-beating TransACT rolls out open platform" *Media Day*, 14 March 2001.

³² Ibid.

³³ Ibid.

³⁴ Austar United Communications Limited (Austar), *Annual Report*, 2000 at 18.

³⁵ Austar United Communications Limited (Austar), *Submission to the Productivity Commission's Review of Telecommunications Specific Regulation – Additional Terms of Reference*, February 2001 at 1.

- **FOXTEL** offers its full service via satellite to a large percentage of regional Western Australia (subject to dish size limitations).
- **Boomerang** offers CNN, CNNfn, Animal Planet and ESPN via satellite and Internet services via modem³⁶.

It is therefore clear that regional operators are able to begin pay TV services in regional areas, with access to substantial non-exclusive programming.

FOXTEL submits that where an established operator with exclusive rights to some pay TV programming is contemplating extending its service to an area which it does not yet service, it should be encouraged to do so. If other operators are given access to its programming, so that it would not be able to differentiate its channel line-up, this will provide a strong disincentive to extend its service into these additional areas, particularly as the business model in regional areas is more difficult. Removing this disincentive for growth by existing operators is not in the interests of consumers. Rather, it is in the interests of consumers to have access to a diversity of programming by different operators.

However, where a licensee has no intention of offering a service in a particular area, then clearly it would be in the licensee's interest to negotiate to sub-licence its programming rights to an operator in that area. However this should be left to commercial negotiation and there is no suggestion that any commercial terms negotiated between a regional pay TV provider and an exclusive licensee for a sub-licence will be unreasonable.

Where services are not being rolled-out in regional areas, it is not because of lack of access to any particular supply of programming but because the market is much smaller than in metropolitan areas which means penetration is likely to be much lower which makes the business model much more difficult to justify.

The Commission has suggested that its real concern is not with pay TV, however, which is now available to most consumers in Australia and which operates in a highly competitive market including free-to-air television, cinema and videos. The Commission has suggested that its real concern is investment in infrastructure that is used to deliver other non-pay TV services, particularly high speed internet services.

We discuss this in section 5 below.

³⁶ See Boomerang TV Website at: <http://home.iprimus.com.au/media9/pay-tv.htm>

5. Effects of pay TV content exclusivity on the development of non-pay TV services

The Commission has raised the effect of the exclusive pay TV content supply arrangements on non-pay TV services as a concern, perhaps the major concern. The Commission in fact states that “the absence of competition in the delivery of pay TV itself may be a secondary concern”³⁷.

The Commission has noted that there “are significant economies of scope”³⁸ between telecommunications and pay TV and that “over the shorter term, the feasibility of cable networks may depend on the viability of pay TV”³⁹. The suggestion is that without access to pay TV content, it may not be possible to invest in the infrastructure necessary to deliver these other services, such as high speed Internet, and that participants with market power in one market may use this power to foreclose competition in the other market⁴⁰.

It is not clear to FOXTEL why only pay TV can generate the revenue necessary to invest in the infrastructure necessary to provide non-pay TV services like high speed Internet. The TransACT example shows that although some economies of scope exist in relation to bundling, the revenue necessary for investment in broadband infrastructure could come initially from providing non-pay TV services, in particular telephony. In fact, the Commission recognises that many potential investors see pay TV as an “add on” service once the data or internet side of the business is developed⁴¹. In this circumstance, it is unclear to FOXTEL why access to movies and sport programming is “essential”.

FOXTEL, the largest pay TV provider in Australia, with approximately 720,000 subscribers, does not bundle its service with any other service, either through cable or satellite. FOXTEL’s service is a stand alone service. Telstra does not bundle its Internet or telephony services with pay TV, nor does Vodafone or many other telephone resellers bundle their product with any other. This demonstrates that bundling is not necessary to the success of a pay TV provider or a telecommunications provider.

Optus appears to suggest that it has not been as successful as it could be due to lack of access to programming which is currently held exclusively by FOXTEL⁴². FOXTEL believes that Optus has not been as successful as it could have been due to a series of factors such as shareholder issues, funding issues and technology problems, despite overtaking FOXTEL in the number of subscribers in 1996. FOXTEL has managed to secure large numbers of subscribers due to its successful investment decisions, strategic marketing campaigns and constant addition of channels, rather than any bundling or vertical integration.

FOXTEL therefore submits that access to pay TV programming is not essential or crucial to investment in broadband infrastructure. Revenue can be generated from other services and, in any case, pay TV programming is available and accessible by providers in regional

³⁷ Productivity Commission, *Telecommunications Competition Regulation*, Draft Report, March 2001 at 16.15.

³⁸ Id at 16.1 and 16.11.

³⁹ Id at 16.11.

⁴⁰ Ibid.

⁴¹ Productivity Commission, *Telecommunications Competition Regulation*, Draft Report, March 2001 at 16.7.

⁴² See generally, Cable and Wireless Optus, *Submission to the Productivity Commission’s ‘Review of Telecommunications Specific Competition Regulation: additional matters under reference’* 2001.

areas. In FOXTEL's view, it is not necessary to the future viability of facilities-based competition in regional areas for the commercial arrangements of metropolitan pay TV providers to be interfered with.

6. Overseas Experience

6.1 General

The Commission has asked for comment on the ACCC's proposal to implement a programming access regime in Australia similar to the one that operates in the US⁴³. FOXTEL discusses the viability of implementing such a regime in Australia in section 7 below.

In this section, FOXTEL makes some general comments on the overseas experience and its relevance to Australia.

The ACCC proposes that regulation or intervention may be necessary to facilitate access to pay TV programming by new, existing or potential pay TV entrants in Australia⁴⁴. The ACCC advocates intervention on the basis of the apparent success of governmental regulation overseas. The ACCC has said⁴⁵:

In the UK and US, access to programming has been recognised as a key factor in establishing structurally-competitive industries. And in both countries, there has been regulatory intervention to open up key pay TV programming to new entrants.

The ACCC recommends that the Commission consider the application of the US program access regime as being economically worthy of implementation in Australia for the ultimate benefit of telecommunications and pay TV consumers, particularly those in regional Australia⁴⁶. Similarly, Optus has pushed for government intervention to ensure that access to key pay TV programming is available on fair and non-discriminatory terms⁴⁷.

FOXTEL submits that what might be appropriate or necessary to encourage competition in the UK and US pay TV industries is not automatically appropriate or necessary in Australia. The UK and US industries are far more developed than the pay TV industry in Australia and intervention, certainly at this stage of industry development, would be premature. Table 6.1 shows the vast disparities of the penetration of pay TV as between the Australian, US and UK markets.

⁴³ Productivity Commission, *Telecommunications Competition Regulation*, Draft Report, March 2001 at 16.32.

⁴⁴ Australian Competition and Consumer Commission, *Submission to the Telecommunications Service Inquiry (Besley Inquiry)*, 2001 Part 2 and Supporting Papers.

⁴⁵ Australian Competition and Consumer Commission, *Submission to the Telecommunications Service Inquiry (Besley Inquiry)*, 2001 Part 2 and Supporting Papers at 2.

⁴⁶ Australian Competition and Consumer Commission, *Submission to the Telecommunications Service Inquiry (Besley Inquiry)*, 2001 Part 2 and Supporting Papers at 4.

⁴⁷ Cable and Wireless Optus, *Submission to the Productivity Commission's "Review of Telecommunications Specific Competition Regulation: additional matters under reference"* 2001 at 5.

Table 6.1

Pay TV Penetration: International Comparisons		
Country	Penetration	Years since launch
US	83.8% (cable, satellite and terrestrial) (June 2000)	50 years
UK	31.6% (cable and satellite) (June 2000)	15 years
Australia	20% (Austar, FOXTEL and Optus) (May 2001)	6 years

Sources: FCC Seventh Annual Report Jan 2001; Meryll Lynch Global Satellite Marketplace 2001 and Annual Reports.

Indeed, the Commission acknowledges that such intervention could be risky given that the Australian pay TV industry is⁴⁸:

...new and developing, alternative platforms for broadband services are emerging and the effect on competition is unclear.

Similarly, Optus has acknowledged that the pay TV industry in Australia is relatively immature⁴⁹. It is not appropriate to adopt a regime that is applicable to one industry structure and assume that it will operate effectively in another.

6.2 United States

The US cable television market is established, mature, competitive and lucrative. Cable television first began to appear in the US in the late 1940's and is now big business⁵⁰. The United States District Court, Alabama, recognised this in *Storer Cable Communications v Montgomery* (1993) 826 F. Supp. 1338, saying, at 1345:

The production, transmission, distribution, and sale of cable television programming is a major industry in the United States, grossing billions of dollars in annual sales.

The US cable industry continues to grow and, as of June 2000, basic cable television subscribership was estimated at around 67.7 million⁵¹.

FOXTEL submits that there are major and fundamental differences between the US and Australian pay TV industries:

⁴⁸ Productivity Commission, *Telecommunications Competition Regulation*, Draft Report, March 2001 at 16.31.

⁴⁹ Cable and Wireless Optus, *Submission to the Productivity Commission's "Review of Telecommunications Specific Competition Regulation: additional matters under reference"* 2001 at 27.

⁵⁰ US House of Representatives, Committee on the Judiciary, "Judiciary To Take Up Antitrust and Broadband Access" *In Brief*, 1999 at 3. Also see Federal Communications Commission, *Facts Sheet – Cable Television Information Bulletin*, June 2000.

⁵¹ Federal Communications Commission, *Annual Assessment of the Status of Competition in the Markets for the Delivery of Video Programming*, Seventh Annual Report, 2000 at 4.

- ◆ The US pay TV industry has been characterised by high levels of vertical integration, which have evolved out of affiliations between program suppliers and cable operators (cable monopolies)⁵². The level of vertical integration between pay TV operators and program suppliers in Australia is significantly lower than in the US;
- ◆ The US pay TV industry is characterised by extensive exclusive content supply arrangements whereas there are fewer exclusive content supply arrangements in Australia;
- ◆ There are a large number of subscribers (67.7 million on cable) to pay TV in the US whereas the Australian pay TV industry is still developing with around 1.4 million subscribers. The potential size of the industry in Australia is also insignificant compared to the US;
- ◆ Pay TV companies in the US are making substantial profits whereas pay TV companies in Australia are yet to make a reasonable return on investment; and
- ◆ The history of the development of the US pay TV industry was also characterised by local cable television providers who originally had geographic monopolies⁵³.

In 1992, after pay TV had been established for many years in the US and was already a multi-million dollar industry, the Federal Communications Commission (**FCC**) enacted the *Cable Television Consumer Protection and Competition Act 1992* (**the Cable Act**) which prohibits arrangements between vertically integrated satellite program suppliers and pay TV operators from engaging in unfair practices, the purpose or effect of which is to significantly hinder or prevent any pay TV operator from broadcasting programming to subscribers. The access rules cover conduct such as undue influence and discrimination, price discrimination, exclusive programming in unserved areas (per se illegal), exclusive programming in served areas (public interest factors) and program sub-licensing.

The legislation applies to vertically integrated cable operators only (ie, an ownership level of 5% or more), and although there have been calls to expand the rules to apply to all cable operators, the FCC has held off expanding these laws for fear of over-regulation⁵⁴. It also only applies to programming suppliers that deliver programming via satellite, not suppliers that deliver programming terrestrially⁵⁵.

As noted in the introduction to the Cable Act itself, the Cable Act was introduced at a time when, due to the local franchising requirements and cable monopolies, cable operators had substantial market power in their geographic area and there was little if any competition between operators as a result. Due to the high level of take-up of cable pay

⁵² Australian Competition and Consumer Commission, *Submission to the Telecommunications Service Inquiry (Besley Inquiry)*, 2001 Part 2 and Supporting Papers at “US Program Access Regime” p1 and Federal Communications Commission, *Annual Assessment of the Status of Competition in the Markets for the Delivery of Video Programming*, First Annual Report, 1994 at para 162.

⁵³ Australian Competition and Consumer Commission, *Submission to the Telecommunications Service Inquiry (Besley Inquiry)*, 2001 Part 2 and Supporting Papers at “US Program Access Regime” p1; Federal Communications Commission, *Annual Assessment of the Status of Competition in the Markets for the Delivery of Video Programming*, Seventh Annual Report, 2000 and Cable Television Consumer Protection and Competition Act of 1992, USA, 105 Stat 1460.

⁵⁴ Australian Competition and Consumer Commission, *Submission to the Telecommunications Service Inquiry (Besley Inquiry)*, 2001 Part 2 and Supporting Papers at “US Program Access Regime” at 4.

⁵⁵ Federal Communications Commission, *Annual Assessment of the Status of Competition in the Markets for the Delivery of Video Programming*, Seventh Annual Report, 2000 at para 178.

TV services (over 60% of households with televisions)⁵⁶ which made cable operators a “dominant” medium and the increasing level of vertical integration between cable operators and programming suppliers, the Act was introduced. The stated policy of the Act is to⁵⁷:

- ◆ *promote the availability to the public of a diversity of views and information through cable television and other video distribution media;*
- ◆ *rely on the marketplace, to the maximum extent feasible, to achieve that availability;*
- ◆ *ensure that cable operators continue to expand, where economically justified, their capacity and the programs offered over their cable systems;*
- ◆ *where cable television systems are not subject to effective competition, ensure that consumer interests are protected in receipt of cable service; and*
- ◆ *ensure that cable television operators do not have undue market power vis-a-vis video programmers and consumers.*

The US situation is therefore clearly distinguishable from the Australian situation as in Australia, there are no cable monopolies and cable operators face competition from other cable operators (particularly in metropolitan areas where there is a substantial overbuild), there is a real threat of entry from new cable operators and also from satellite operators and free-to-air television (which is a much stronger competitor in Australia than in the US).

In addition, as mentioned above, at the time when the US legislation was introduced, as a result of the peculiar US situation, the level of vertical integration between cable operators and programming services was a lot greater than currently exists in Australia (Australia's level of vertical integration is currently approximately only 20%⁵⁸). In its 1994 report into competition in pay TV markets, the FCC noted that approximately 53% of programming services were vertically integrated with cable system operators, with 50% in 1990⁵⁹. In the FCC's 1990 Cable Report, the FCC noted that all of the successful channels that were introduced up to that point were affiliated with cable operators and that “*vertically-integrated national programming services dominate the group of services that are most widely viewed*”⁶⁰.

In the most recent FCC Report, however, the FCC has noted that “*the proportion of vertically integrated channels continues to decline*” and now only 35% of programming networks are vertically integrated with a cable operator⁶¹. The FCC also notes that the prohibition on cable exclusivity in the legislation ceases to be effective on 5 October 2002 unless the

⁵⁶ Cable Television Consumer Protection and Competition Act of 1992, USA, 105 Stat 1460 – see Findings – sec 2(a)(3).

⁵⁷ Cable Television Consumer Protection and Competition Act of 1992, USA, 105 Stat 1460 – see Statement of Policy – sec 2(b).

⁵⁸ Figure determined by dividing number of channels in Australia in which a pay TV operator holds a voting or non-voting interest of 5% or more (using the US definition of “attributable interest” as described in ACCC report at 54 above) of which FOXTEL is aware by the number of channels broadcast by pay TV operators in Australia as per Annexure 1.

⁵⁹ Federal Communications Commission, *Annual Assessment of the Status of Competition in the Markets for the Delivery of Video Programming*, First Annual Report, 1994 at para 161.

⁶⁰ Id at para 162.

⁶¹ Federal Communications Commission, *Annual Assessment of the Status of Competition in the Markets for the Delivery of Video Programming*, Seventh Annual Report, 2000 at para 173.

FCC finds the prohibition continues to be necessary⁶². The FCC said that it would continue to monitor the situation.

Further, the stated policy of the Cable Act was to **increase diversity** and encourage cable operators to expand the programs offered to customers. In Australia, where there is cable overbuild and competition from various pay TV providers and free-to-air providers, this will not be achieved by legislating open access to programming; rather, it will be achieved by encouraging Australian operators to produce or source their own programming that is different to the programming currently distributed in Australia.

The US courts have recognised that exclusive programming arrangements may increase interbrand competition in respect of cable systems and programming⁶³.

In *Futurevision Cable System v Multivision Cable TV* (1992) 789 F. Supp 760, the court, in considering whether exclusive supply arrangements relating to the Learning Channel and ESPN Sunday Night Football breached sections 1 or 2 of the *Sherman Act*, held, following an established line of authority at 768:

While vertical restrictions may reduce intrabrand competition by limiting the number of sellers of a particular product, competing for a given group of buyers, they also promote interbrand competition by allowing manufacturers to achieve certain efficiencies in the distribution of its products.

The court held that the exclusive dealing contracts in this case did not have an anti-competitive effect on interbrand competition. Notably, the court recognised that Futurevision was able to substitute other comparable programming holding at 770 that:

Indeed, it is quite reasonable to infer from Futurevisions's allegations that the exclusive contracts have increased interbrand competition by causing overbuilders such as Futurevision to go to suppliers other than ESPN and The Learning Channel to purchase programming. From the cablevision viewer's perspective, it is equally clear that the exclusive contracts increase the diversity of programming available to the viewing public. Thus, while the vertical restraints in this case may eliminate some intrabrand competition, the court concludes that they tend 'to be potentially beneficial to interbrand competition'.

The Court also found that the programming in question was not “essential” as the overbuilder had access to sufficient programming elsewhere to allow it to enter and succeed in the relevant market. *Futurevision* was able to obtain content from other sources and still operate a viable service in the market. In effect, the exclusive supply agreements actually increased competition for pay TV content in Mississippi and ultimately gave consumers more diverse programming choices. Rather than being anti-competitive, these exclusive arrangements were regarded as pro-competitive.⁶⁴

This case demonstrates how exclusive program arrangements can aid the competitive process and encourage a more diverse range of programming options for consumers.

⁶² Federal Communications Commission, *Annual Assessment of the Status of Competition in the Markets for the Delivery of Video Programming*, Seventh Annual Report, 2000 at para 179.

⁶³ Australian Competition and Consumer Commission, *Submission to the Telecommunications Service Inquiry (Besley Inquiry)*, 2001 Part 2 and Supporting Papers at “US Program Access Regime” at 2.

⁶⁴ See also Federal Communications Commission, *Petition for Public Interest Determination by New England Cable News 94-133*, 1 June 1994 where the FCC granted NECN the right to enter into exclusive programming deals with its cable affiliate in six new England states. The FCC held that exclusivity would not have an adverse effect on the development of competing pay TV operators, it was critical to attract investment and secure distribution which was essential to its financial viability and it would foster program diversity by promoting its financial survival. See also: Australian Competition and Consumer Commission, *Submission to the Telecommunications Service Inquiry (Besley Inquiry)*, 2001 Part 2 and Supporting Papers at “US Program Access Regime” at 6.

FOXTEL, in entering exclusive programming arrangements, actually assists the competitive process by specialising in particular types of content in order to build brand equity and foster diversity.

In another case, *Storer Cable Communications v Montgomery* (1993) 826 F. Supp. 1338, the exclusive arrangements were found to be in breach of the *Sherman Act* as the suppliers and operators were vertically integrated and the cable operators were found to possess market power.⁶⁵ The Court also found that, based on the facts of that case, there was no comparable or substitutable programming alternatives available. This case simply demonstrates, however, that depending on the circumstances of the particular arrangement it may be found to be anti-competitive. This has not been demonstrated in Australia.

What these cases show is that existing anti-trust regimes can and are used to prevent anti-competitive behaviour in the US. The specific programming legislation in the US was enacted to deal with a problem about access to programming which arose out of the particular history of the development of pay TV in the US through regional cable monopolies and the high level of vertical integration that this fostered. It does not justify the imposition of similar regulation in the immature Australian industry which has not demonstrated similar problems.

6.3 United Kingdom

There is no specific access regime in the UK despite the existence of vertical integration in the UK between program suppliers and cable TV operators. Nor has the existence of one single satellite provider (BSkyB), with a dominant position in providing pay TV in the UK for some time, which competes with local cable companies, warranted the establishment of an access regime for Pay TV in the UK.

The Office of Fair Trading (**OFT**) has, however, found that BSkyB possessed “monopoly” power within the markets for the supply of premium sports and movie programming and that it used this to hinder competition via vertical restraints⁶⁶. The OFT accepted certain undertakings from BSkyB regarding the making available of key programming to cable competitors and keeping regulatory accounts detailing terms and conditions of program supply⁶⁷.

Accordingly, regulation of pay TV in the UK occurred because BSkyB was found to be in breach of existing competition laws because of its monopoly position in the relevant market. This indicates that it is unnecessary to adopt the US model to deal with anti-competitive conduct, and that competition laws are effective without further intervention.

If there was any breach of such laws in Australia, it would be open for the regulator to take action. FOXTEL does not agree that the current laws are insufficient or are unable to deal with issues relating to pay TV programming. If there is no misuse of market power or substantial lessening of competition in any relevant market for pay TV services then that means there is no need for market intervention.

⁶⁵ Note, however, that this case is of limited precedent as it was vacated after settlement.

⁶⁶ Australian Competition and Consumer Commission, *Submission to the Telecommunications Service Inquiry (Besley Inquiry)*, 2001 Part 2 and Supporting Papers at “Program Access in the United Kingdom” at 1.

⁶⁷ *Ibid.*

6.4 Europe

Access to pay TV programming has not been a major issue under the European Community's competition law⁶⁸.

There is no specific program access regime in the EC, nor has the European Council or Commission issued any directives on the subject⁶⁹. However, the European Commission has considered that the exclusive right to televise a sports event is natural and does not, in itself, infringe Article 85 of the European Community Treaty (like s45 of TPA), unless the period of exclusivity is too long or there is a cumulative effect from a series of exclusive contracts⁷⁰.

⁶⁸ Australian Competition and Consumer Commission, *Submission to the Telecommunications Service Inquiry (Besley Inquiry)*, 2001 Part 2 and Supporting Papers at "Telecommunications and Pay TV Connection" at 2.

⁶⁹ Australian Competition and Consumer Commission, *Submission to the Telecommunications Service Inquiry (Besley Inquiry)*, 2001 Part 2 and Supporting Papers at "Program Access in the European Community" at 1.

⁷⁰ Ibid.

7. The case for access to programming

The Commission has asked for the views of industry participants on the options available to deal with any perceived problem of access to pay TV programming⁷¹.

The Commission's 4 options are⁷²:

- (1) Legislate to open up access to pay TV programming where it is necessary for competition in pay TV or non-pay TV.
- (2) Use the general provisions of Part IV of the TPA to deal with any problems of access to pay TV programming.
- (3) Extend the existing Part XIC access regime to pay TV programming.
- (4) Do nothing but monitor the development of pay TV in Australia, and the effect of exclusive program arrangements.

7.1 Legislation opening up access to programming

Regulatory or legislative intervention in the Australian pay TV market is inappropriate, and would be detrimental, for the following reasons:

- ◆ The pay TV industry is still developing and responding to investment interests and is yet to provide a reasonable return for investors;
- ◆ Pay TV penetration in Australia is significantly lower than in the US and UK;
- ◆ There are fewer exclusive content supply arrangements in Australia than in overseas markets;
- ◆ The level of vertical integration in Australia is much less than in the USA, particularly at the time of the introduction of the Cable Act;
- ◆ The small size of the Australian market for pay TV services cannot be compared to that of the US, UK or European markets;
- ◆ Competition in Australia is already intense in metropolitan areas (at least 2 pay TV providers, 5 free-to-air television stations, cinemas and videos);
- ◆ Demand for pay TV in regional areas is not analogous to metropolitan areas and regional providers have access to sufficient revenue drivers in the form of pay TV programming and other services; and
- ◆ Australia trade practices laws are capable of regulating anti-competitive practices.

Given its immaturity, particularly as compared to the US and UK industries, FOXTEL submits that the Australia pay TV industry is already over-regulated, almost more than any other industry. FOXTEL also submits that it has not been demonstrated that access to programming has been foreclosed or that this is causing lack of investment in pay TV infrastructure. The Commission's concern in any case appears to be access to infrastructure for non-pay TV services and, as these services are only just beginning to emerge, FOXTEL submits that it is far too early to make any judgment about the

⁷¹ Productivity Commission, *Telecommunications Competition Regulation*, Draft Report, March 2001 at 16.32.

⁷² Productivity Commission, *Telecommunications Competition Regulation*, Draft Report, March 2001 at 16.21.

competitiveness or availability of these services, particularly in regional areas where the demand is as yet unknown and may be limited.

FOXTEL also submits that it is an unreasonable interference with commercial arrangements to impose on the program supplier a condition that it cannot discriminate between competing pay TV operators on the price and terms of supply. There could also be an issue of enforceability as against overseas suppliers. There is no evidence that this discrimination occurs in relation to non-exclusive supply arrangements. The general prohibition on price discrimination has been taken out of the TPA. Again, these arrangements should not be placed in any different position to other services supplied under the TPA.

7.2 Existing Part XIC Regime

FOXTEL similarly submits that it would be inappropriate for the existing access regime in Part XIC to be extended to programming. That regime is designed to open up access to telecommunications infrastructure to encourage facilities-based competition. FOXTEL submits that imposing a similar access regime in relation to programming would in fact provide a disincentive to this future investment in infrastructure as it would reduce the ability of pay TV providers to compete.

FOXTEL submits that any further regulation of the pay TV industry, in particular in relation to pay TV programming content, would be an unreasonable and unnecessary interference with commercial arrangements.

7.3 Existing Part IV Regime

The general provisions in Part IV of the TPA are open to the ACCC or any interested person to rely on if the necessary anti-competitive behaviour is established. As discussed in Part 6, these provisions have been used in the US and UK to deal with anti-competitive programming supply arrangements and conduct on the part of a monopolist. FOXTEL submits that any difficulty in establishing a case for intervention under Part IV of the TPA simply demonstrates that the arrangements are not anti-competitive and should not be interfered with. It should not be used an argument for further unnecessary intervention. Facilities-based competition in the pay TV industry is already heavily and adequately regulated under Part XIC.

Supply arrangements regarding pay TV programs should be dealt with, where necessary, under Part IV of the TPA like any other supply arrangement. If the requisite market power or substantial lessening of competition cannot be found, then the exclusive rights should not be interfered with. There has been no case shown that pay TV should be subject to a more stringent level of regulation than other services, many of which are more “essential” than pay TV.

7.4 Monitor developments

FOXTEL submits that the existing pay TV content programming arrangements are not anti-competitive and do not foreclose facilities-based competition in either regional or metropolitan areas for pay TV or non-pay TV services. FOXTEL therefore agrees with the Commission that the appropriate course of action is to do nothing at this stage. FOXTEL has no objection, however, if the Commission wishes to monitor the situation and would be willing to co-operate in that regard.

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Table of Cases

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Storer Cable Communications v Montgomery (1993) 826 F. Supp. 1338.

Schedule 1

Channel Suppliers for Pay TV in Australia as at 4 June 2001									
Channel Supplier	Selected Channel	Channels carried by...							
		FOXTEL	Optus Television	Austar	Neighborhood Cable (Mildura)	TPG Boomerang	TARBS	Access 1	Transact
PMP (distributor FOXTEL)	Showtime	✓		✓	✓				
	Encore	✓		✓	✓				
	Showtime 2	✓							
Movie Network	Movie One		✓	✓					
	Movie Extra		✓	✓					
	Movie Greats		✓	✓					
C7	C7 Sport 1		✓	✓	✓			✓	
	C7 Sports 2		✓						
Fox Sports	Fox Sports 1	✓		✓					
	FOX Sports 2	✓		✓					
	NRL on Optus		✓						
XYZ Entertainment	Arena	✓		✓					
	Discovery	✓		✓					
	Lifestyle	✓		✓					
	Nickleodeon	✓		✓					
	[V] Channel	✓		✓					
	MusicMax	✓		✓					
FOXTEL	Fox 8	✓		✓					

	<i>Fox Kids/ Fox Classics</i>	✓							
	<i>fX</i>	✓		✓					
	<i>FOXTEL Weather</i>	✓							
FOX News Network	<i>Fox News</i>	✓							
TV1 Partnership (distributor FOXTEL)	<i>TV1</i>	✓		✓					
National Geographic Australia	<i>National Geographic Channel</i>	✓	✓	✓	✓				
Crown Media	<i>Hallmark</i>	✓		✓	✓				
ESPN Inc	<i>ESPN 1 and/or 2</i>		✓	✓	✓	✓	✓		
Main Event Television	<i>Main Event (PPV)</i>	✓	✓	✓					
	<i>Adults Only</i>	✓	✓	✓					
Turner Broadcasting	<i>Turner Classic Movies</i>	✓	✓	✓	✓		✓		
	<i>CNN</i>	✓	✓	✓	✓	✓	✓		
	<i>Cartoon Network</i>	✓	✓	✓	✓		✓		
	<i>CNN fN</i>		✓			✓			
Artist Services Cable Management	<i>The Comedy Channel</i>	✓		✓					
Australian News Channel	<i>Sky News Australia</i>	✓	✓	✓	✓				
Sky Channel	<i>Sky Racing</i>	✓	✓	✓	✓		✓		
CNBC Asia	<i>CNBC Australia</i>	✓	✓	✓	✓				✓
Pan TV	<i>World Movies</i>	✓	✓	✓					

Country Music Television	<i>Music Country</i>	✓	✓	✓	✓				
UK TV	<i>UK TV</i>	✓		✓					
Buena Vista	<i>The Disney Channel</i>		✓	✓	✓				✓
Discovery /BBC	<i>Animal Planet</i>		✓		✓	✓			
TV Shopping Network	<i>TVSN (shopping)</i>	✓	✓	✓	✓				
BBC Worldwide	<i>BBC World</i>	✓	✓		✓				✓
Bloomberg	<i>Bloomberg Television</i>	✓		✓	✓			✓	
AETN	<i>The History Channel</i>	✓							
MTV	<i>MTV</i>		✓						
Austar	<i>The Weather Channel</i>			✓					
Fashion TV	<i>Fashion TV</i>	✓			✓				
Overlook	<i>RAI International</i>	✓	✓		✓				
	<i>Antenna Pacific</i>	✓	✓		✓				
	<i>ART</i>		✓						
	<i>LBC</i>		✓						
TARBS	<i>Nightmoves</i>						✓		
Others	<i>Adventure 1</i>		✓						
	<i>Alpha GATV</i>		✓						
	<i>Australian Christian Channel</i>		✓						
	<i>CCTV</i>		✓						
	<i>Chinese</i>						✓		

	<i>Deutsche Welle German</i>				✓				
	<i>EWTN Catholic Network</i>				✓				
	<i>Imparja</i>				✓				
	<i>Italian</i>						✓		
	<i>Korean</i>						✓		
	<i>Lashkara Indian TV</i>				✓				
	<i>Macedonian</i>						✓		
	<i>MCM (music videos)</i>				✓		✓		
	<i>Mega Cosmos</i>		✓						
	<i>Music Videos</i>							✓	
	<i>NHK</i>		✓						
	<i>Odyssey</i>		✓						
	<i>Oh</i>		✓						
	<i>Optus Weather</i>		✓						
	<i>Ovation</i>		✓						
	<i>Parliamentary Channel</i>								✓
	<i>Philippino</i>						✓		
	<i>Phoenix</i>		✓				✓		
	<i>Polish</i>						✓		
	<i>Portugese</i>						✓		
	<i>Russian</i>						✓		
	<i>Spanish</i>						✓		
	<i>TRT Turkish TV</i>				✓				
	<i>Turkish</i>						✓		
	<i>Various Arabic Channels</i>						✓		