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PUBLIC VERSION

Mr Bruce Mikkelsen
Australian Competition and Consumer Commission
GPO Box 3131
Canberra ACT 2601

By email: mergers@accc.gov.au

Dear Mr Mikkelsen

Proposed acquisition of Austar by Foxtel – response to proposed undertakings

This submission is provided by iiNet Limited and its wholly owned subsidiary TransACT Communications Pty Ltd (referred to collectively in this letter as iiNet) in response to the Commission's letter of 7 March 2012 inviting comments about the effectiveness of the section 87B undertaking offered by Foxtel in relation to its proposed acquisition of Austar.

1. INTRODUCTION

The proposed undertaking will have little (if any) meaningful effect on the market for the acquisition of compelling content in the event that the merger is allowed to go ahead. The undertaking also does nothing to address the market dominance issue in the Australian subscription TV market, or related telecommunications markets, and actually exacerbates the issue which will result in a substantial lessening of competition.

It is apparent from the preamble to the proposed undertaking that the main source of competition that is being relied on to provide competitive restraint is IPTV. The only way that this can realistically be achieved is if the undertaking improves the access to compelling content for new and emerging IPTV providers to a level where those IPTV providers will actually be in a position to compete with the merged entity for the acquisition of content. It is impossible for this objective to be achieved unless IPTV providers have access to premium content that is capable of attracting large numbers of subscribers. If IPTV providers are not able to attract large numbers of subscribers, they will never be in a position to negotiate access to compelling content, particularly in a competing bid against a merged Foxtel and Austar.

2. SUMMARY OF THE LIMITATIONS OF THE UNDERTAKING

The proposed undertaking will not address the ACCC's competition concerns in relation to both the national subscription television market and the telecommunications markets.

- It does not actually provide access to any content. There is no requirement on Foxtel to provide wholesale open access to any of its content or channels.
- It allows the merged entity to continue to acquire exclusive cable, satellite and mobile rights.
- The proposed undertaking only concerns the opportunity to negotiate for access to content distributed by some IPTV platforms.
- Consumers want access to a range of content at any time, anywhere and on any device. iiNet customers expect to be able to move content received on a linear channel over IPTV onto their mobile phone or tablet. The undertakings fail to address this reality of the overall market for subscription television by failing to provide a technologically neutral solution. The proposed undertaking is therefore likely to have the effect of restricting consumer choice and technological innovation.
- The proposed undertaking does nothing to improve access to the critical subscription driving content of premium domestic sport.
- The proposed undertaking only provides the opportunity to negotiate for limited access to other compelling content such as new release movies and popular general entertainment channels:
    - The proposed undertaking has no impact on existing exclusive contracts.
    - Much of Foxtel's popular content such as the widely known Showtime, Nickelodeon and National Geographic channels will still remain exclusive to the merged entity.
    - Even the opportunity to negotiate for limited categories of content such as some Movie TVOD rights is limited to individual films and not movie channels.
- There are only limited restrictions in the proposed undertakings on Foxtel in entering into new exclusivity arrangements with independent content suppliers.
- The undertaking does nothing to address the commercial challenges faced by iiNet in negotiating with large rights holders such as the major movie studios. These very real commercial barriers include terms such as 'minimum subscriber numbers' imposed by content providers.
- The undertaking does nothing to address the competitive advantage enjoyed by Telstra and further entrenched by virtue of its 50% ownership of Foxtel:
    - It is uneconomic for iiNet to offer IPTV in areas where it requires access to Telstra's wholesale DSL service;
    - In these areas, iiNet will be unable to compete with Telstra for the supply of bundles of broadband, voice, Pay TV and mobile products; and

- The undertaking does nothing to restrict Telstra from becoming as dominant in the IPTV market as it is in the telecommunications markets.

In these circumstances, the Commission must reject the proposed undertaking.

3. THE PROPOSED MERGER DRAMATICALLY INCREASES EXISTING BARRIERS TO ENTRY

A duopoly would become a monopoly

For historical reasons, the market for the acquisition of subscription television content in Australia is a virtual duopoly between Foxtel and Austar. At February 2012, Foxtel's total subscriber base, including wholesale subscribers, reached over 1.66 million.[1] Austar has approximately 700,000 subscribers, such that the merged entity would have approximately 2.4 million subscribers. However, iiNet estimates that the IPTV subscribers in Australia (excluding Telstra customers) is only several thousand.

Multiple barriers to entry

The lack of competition in the subscription television market is the result of a handful of inter-related barriers to entry:

1. lack of access to content distribution infrastructure (including access to Telstra's wholesale ADSL service on appropriate terms), in relation to which see further below in section 7); and

2. lack of access to the compelling content necessary to attract significant numbers of subscribers.

The barrier to entry created by lack of access to compelling content is exacerbated by:

3. the need to achieve terms such as the minimum subscriber guarantees required by the suppliers of compelling content; and

4. the ability of Foxtel and Austar to lock up content in exclusive deals with content suppliers.

It is impossible for new entrants to achieve the kind of scale necessary to overcome the barriers to entry referred to in points 2-4 above. Access to distribution infrastructure also remains a significant barrier to entry. Although service providers such as iiNet are able to offer high definition IPTV to their "on-net" customers, it remains uneconomic for IPTV to be supplied off-net (notwithstanding the declaration of wholesale ADSL, as elaborated further below).

A merger would exacerbate the barriers

iiNet accepts that the above barriers to entry are not created by the merger, however, these barriers will be significantly exacerbated by the merger. As Foxtel has identified, if the acquisition proceeds the transaction will create "one of Australia's largest media organisations"[2]. The already very challenging existing barriers to entry are made far worse by a 40% increase in the size of Foxtel that will further strengthen the merged

[1] Foxtel press release, 'Foxtel announces solid results in face of tough consumer environment', 9 February 2012
[2] Foxtel press release, 'Foxtel announces undertakings to ACCC, 16 March 2012

entity's ability to lock up compelling content. In the market for the acquisition of compelling content, bargaining power is directly related to the size of a participant's subscriber base. The increase in Foxtel's ability to lock up content that will be created by the merger is not effectively constrained by the proposed undertaking.

4. ANY UNDERTAKINGS MUST INCLUDE ACCESS TO LIVE DOMESTIC SPORT

Live sport is the core subscription driving content

In its letter to interested parties dated 7 March 2012, the ACCC states:

> …The proposed undertaking is not intended to resolve competition concerns or structural issues that may already exist in the relevant markets and do not arise as a result of the proposed acquisition
>
> In this regard, the ACCC considers that to the extent that Foxtel's (and its shareholders') ownership of exclusive sports rights may raise competition concerns, these concerns exist independently of the proposed acquisition. While premium domestic sport is therefore not offered as part of the undertaking the ACCC considers that a package of content which does not include this sport should be sufficient to address the competitive harm that is likely to arise as a result of the proposed acquisition.

Access to live sport is the most significant content in terms of attracting subscribers. This has been consistently recognised by regulatory authorities and the content providers for decades. For example, in 2005, Graeme Samuel said "Crucial to the success of any ventures using these new technologies, though, will be content rights, and control of premium sporting content, such as AFL, rugby, rugby league, cricket and tennis, could be pivotal. It is therefore vital that no single network owner acquires exclusive rights to all that content and effectively locks out the potential competition."[3]

Foxtel itself has recognised the capacity of premium sporting content to attract subscribers. Discussing Foxtel's half yearly results in February this year, CEO Richard Freudenstein said he was confident the comprehensive sporting coverage lined up for 2012 would attract new customers to Foxtel[4] and that despite economic headwinds, there has been a better-than-expected pick up in subscriber numbers thanks to the launch of its dedicated Australian Football League channel.[5]

To take a recent example of the allure of sporting content, in 2011 the New Zealand v Australia semi-final of the Rugby World Cup was the highest-rating program in subscription television history. The tournament was watched by over 40% of total Foxtel/Austar subscribers.[6]

In October 2010, in a market report authored by CASBAA 'Australia in View', it was noted that:

[3] Graeme Samuel, ACCC, Henry Mayer Lecture, 19 May 2005, pg 7

[4] 'Foxtel lifts subscriber base', Canberra Times, 9 February 2012, http://www.canberratimes.com.au/business/earnings-season/foxtel-lifts-subscriber-base-20120209-1rlt7.html

[5] Foxtel tips benefit from new AFL channel, Brisbane Times, 23 February 2012, http://news.brisbanetimes.com.au/breaking-news-business/foxtel-tips-benefit-from-new-afl-channel-20120223-1tp5a.html

[6] Source: OzTAM National STV Homes, Consolidated Data, 16/10/2011, Total People, Projections

> Operators such as SelecTV, FetchTV and TransACT have demonstrated that a reasonable basic package can be assembled but the lack of premium sports makes it difficult to compete.[7]

If anything this observation about the difficulties to compete, must in 2012 be expressed more strongly. Since January 2011, SelecTV which was a satellite based subscription based broadcasting service is no longer available; it entered into voluntary administration in February 2011[8]. At the time, media analyst Greg Fraser asserted that SelecTV's lack of sports programming was a contributing factor to the company's demise, making it difficult to lure dissatisfied Austar and Foxtel customers to the service[9].

No access to live sport means no competition

Without access to live sport, it is highly unlikely that an iiNet ITPV service or any other new or emerging IPTV providers will ever provide significant competition to the merged entity. That the market for acquisition of exclusive sports rights may already be anti-competitive without the merger is no reason not to address this significant component of the access to content issue in the undertakings. Access to domestic sport rights for smaller competitors will be made even more unattainable by the merger.

No evidence and no reason for excluding sport

It is unclear to iiNet why the ACCC has treated access to sports content differently to other content in the proposed undertakings. There have been no reasons or evidence provided to iiNet to support the exclusion of access to sports content from the scope of the undertakings. Nor have there been any reasons provided to support the view that a package of content which does not include premium sport should be sufficient to address the competitive harm that is likely to arise as a result of the proposed acquisition.

If no access to sport, the ACCC should oppose the merger

If the ACCC takes the view that undertakings cannot address all of the barriers to entry that will be substantially increased by the merger (including arguably the most significant of them all, access to sport), then it should oppose the merger outright and reject Foxtel's proposed undertakings.

5. ACCESS TO PREMIUM CONTENT – MOVIES & POPULAR ENTERTAINMENT CHANNELS

Premium content is generally the significant driver of subscription to content based services. As Ofcom has highlighted, "live high-quality sport and recent Hollywood movies retain an enduring appeal for many consumers. Access to this content has driven the historical development of pay TV, and we believe it will remain crucially important for the development of new platforms and new services."[10]

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[7] CASBAA market report, Executive Summary, 'Australia in View', October 2010
[8] http://www.mediaspy.org/report/2011/02/04/time-called-on-wins-pay-tv-company/
[9] http://www.mediaspy.org/report/2011/02/04/time-called-on-wins-pay-tv-company/
[10] Ofcom Pay TV Statement, 31 March 2010, page 1

Only a fraction of linear channels would be contestable

The proposed undertakings do not provide access to sufficient popular movie and thematic television channels (such as Nickelodeon and National Geographic). Subscription Television Australia stated in its weekly media release on subscription TV ratings that in the week ending 12 March 2012 “The Top 5 Channels (by share of viewing) in Week 10 were FOX8, FOX Footy, FOX Sports2, The LifeStyle Channel and FOX Classics”[11]. The undertakings will not provide iiNet with access to any of these popular channels.

An examination of the OzTAM subscription television ratings data[12] shows that of the subscription television channels that rate above a 1% share of viewing in subscription television households, only between around 15-30% are channels that may not be excluded from the restrictions on exclusivity in the proposed undertakings. Of this very limited portion of popular content, an unknown number of channels may remain exclusive for up to 4 years into the term of the proposed undertaking.

To the extent that popular subscription movies and general entertainment content will be theoretically affected by the proposed undertaking, the undertaking will have little meaningful impact. It is iiNet’s understanding the TVOD movies are generally not offered on an exclusive basis in any event. Moreover, the undertakings in relation to movie TVOD only provides restrictions on Foxtel entering into new exclusivity arrangements concerning movies less than 12 months old and only relates to individual movies, not movie channels. Further detail on these issues is set out in attachment A which sets out answers to ACCC’s specific questions on the proposed undertaking.

Wholesale access to content from Foxtel is necessary

Foxtel must provide wholesale access to content on regulated terms on any device across any platform and any technology to address the substantial lessening of competition in the relevant markets. This is not a novel approach. In the course of the Ofcom inquiry a range of international regimes were reviewed[13] before ultimately implementing a comprehensive wholesale access regime in relation to sports content. For example, in France and Spain content access regimes have been applied, but the impact has been limited due to the content subject to the regime being too restricted. In the United Kingdom, Ofcom required Sky to provide access to its core sports channels on a wholesale ‘must offer’ basis[14].

6. UNDERTAKINGS SHOULD APPLY TO ALL PLATFORMS

Why just IPTV?

In the ACCC Statement of Issues, the ACCC took the preliminary view that:

> there is a national market for the supply of subscription television services to consumers. Other sources of supply of audio visual content to consumers,

[11] ASTRA, STV Ratings Week 10, http://www.astra.org.au/Menu/News

[12] OzTam restrict reproduction, publication or communication of its data, so iiNet is unable to reproduce the relevant information in this submission. The ratings are available from www.oztam.com.au. iiNet has assumed that TV1 would be covered by clause 6, however this may not be correct given the apparent cross-over between ownership of TV1 and the description of the Premium Move Partnership in the definition of Affiliated Content Supplier

[13] ibid

[14] See Ofcom Wholesale must-offer remedies: international examples, Annex 11 to pay TV phase three document, 26 June 2009

> including FTA television, mobile TV and internet content, are not sufficiently close substitutes to be considered in the same market.[15]

In its submission dated 11 August 2011, iiNet supported that preliminary definition of the relevant market and made reference to *Seven Network News Ltd v News Ltd*[16] in support of that proposition. The ACCC concludes that the proposed acquisition would have a substantial lessening of competition in the national subscription TV market[17].

However, the proposed undertaking fails to address the whole subscription television market. Despite the ACCC's recognition that providers of subscription television services compete with one another across platforms, the ACCC appears to endorse a focus only on IPTV:

> As the ACCC's competition concerns primarily related to competition using IPTV technology, FOXTEL will retain the ability to acquire exclusive rights for the distribution of content by Cable, Satellite and Mobile Networks to Mobile Devices.[18]

Why exclude mobiles (which excludes popular tablet devices)? Why exclude satellites? Why exclude cables?

The proposed undertaking would allow the merged entity to continue to acquire exclusive cable, satellite and mobile rights. This will totally undermine the ability of the proposed undertakings to address the competition concerns identified by the ACCC, which included that the proposed acquisition would substantially lessen competition in the national market for the retail supply of "subscription television services". That is, the ACCC's concerns relate to supply of subscription television services broadly, be it over any content delivery infrastructure, including optic fibre cable, HFC cable, satellite, mobile networks, wireless networks, IPTV delivered over copper lines or any other delivery mechanisms. Given these concerns relate to many delivery mechanisms, there is no logic for limiting the undertaking to "New Distribution Rights" and allowing Foxtel to maintain exclusivity over cable, satellite, mobile and wireless platforms.

The scope of the undertakings should extend to all content delivery infrastructure. Technologically neutral undertakings would also assist in ensuring that technological developments over the term of the proposed undertaking do not undermine the objectives of the undertakings. As currently drafted, iiNet anticipates that the development of new delivery mechanisms will lead to disputes over whether or not particular clauses of the undertakings apply to this new technology.

Providers of IPTV services compete with traditional Foxtel and Austar subscription based Pay TV in the same way as they compete with other IPTV providers. Allowing the merged entity exclusive access to content on cable, satellite, mobile and wireless undermines the fundamental objective of providing undertakings in relation to acquisition of exclusive content.

Under the definition of New Distribution Rights in the proposed undertaking, Foxtel will be able to hold exclusivity on content on all HFC cables (including the TransACT and Optus' networks), any Telstra FTTP network (which would include networks currently being built, such as the FTTP in South Brisbane and Telstra's Velocity networks), any

[15] ACCC Statement of Issues, 22 July 2011, page 8
[16] [2007] FCA 1062
[17] Letter from ACCC dated 7 March 2012, page 1
[18] Letter from ACCC dated 7 March 2012, page 4

satellite network (including the satellite programs recently announced as part of the NBN) and effectively any mobile or wireless network (including use by mobile devices and tablets).

iiNet's subsidiary, TransACT, would seek to deliver content over its HFC network during the course of the undertaking, so is particularly concerned that Foxtel would be able to continue to acquire exclusive rights over HFC networks using Internet Protocol.

Foxtel's ability to obtain exclusive rights over cable, satellite, mobile and wireless networks will enable it, or its part-owner Telstra, to offer an anytime, anywhere, any device play. Other players like iiNet would be limited to use over a TV screen and materially disadvantaged.

The undertakings should be technologically neutral as it is impossible to predict the impact of technical developments in this space on the scope and impact of the undertakings.

Requirements for minimum subscriber guarantees and high rates unresolved

The restrictions on Foxtel's ability to acquire exclusive rights fails to recognise the difficulties that the smaller operators, such as iiNet and TransACT have in trying to negotiate access with large content providers. These difficulties include:

(a) Minimum guarantees;

(b) Higher per user costs charged to smaller providers, making it harder to compete with Foxtel who can access the same content at a much lower per user rate;

(c) An unwritten, unspoken desire from large content providers not to upset their more significant customers by supplying to those customers' competitors.

No obligations on content providers to enable competition

[REDACTED CIC]

It must be recognised that removing exclusivity is only one component of improving access to content. For the reasons outlined above, it is highly unlikely that a new or emerging provider of IPTV would be in a position to negotiate access to a linear channel, or at least to one that is likely to attract a significant audience.

7. IMPACT OF THE MERGER ON TELECOMMUNICATIONS MARKETS

No remedy for the substantial lessening of competition in telecommunications markets

The ACCC has recognised the impact of the proposed merger on telecommunications markets. In its letter of 7 March 2012, the ACCC stated:

> Further, as telecommunications networks and IPTV products develop, it is likely that it will become increasingly important for retail telecommunications service providers to be able to bundle subscription television content with fixed voice and broadband services in order to be able to compete effectively with other retail telecommunications service providers. The increasing importance of bundling would compound the ACCC's concerns because:

- entry by Austar into telecommunications markets would become both more likely to occur and more likely to have a significant competitive impact, given Austar's ability to access compelling subscription content; and
- the competitive advantage enjoyed by Telstra by virtue of its relationship with Foxtel and consequently, the detrimental effect of extending this relationship to Austar would be likely to increase[19].

Yet despite recognising the very serious harm that the proposed merger will do to the already fragile state of competition in telecommunications markets, the ACCC is considering an undertaking that does almost nothing to address these concerns. An undertaking that is unlikely to make any material difference to the ability of Foxtel's competitors to access compelling content is not capable of addressing the very significant increase in Telstra's market power that will occur as a result of the proposed merger.

Further comments concerning the impact of the proposed acquisition are set out below.

Full IPTV service to Austar areas still uneconomic post-WDSL declaration

No prospect of competition in "off-net" areas

If the merger proceeds, the ACCC should assume that the current Foxtel/Austar geographic market sharing arrangement will end and Foxtel will be available in regional areas[20]. To the extent that iiNet has existing customers in these areas, the majority of these customers are "off-net". That is, these customers are serviced using products such as the Telstra wholesale ADSL product[21]. Telstra will be able to bundle Foxtel (including premium domestic sport) with broadband and voice, offering a triple-play that iiNet and others will not be able to match.

The ACCC declared the wholesale ADSL service under section 152AL(3) of the *Competition and Consumer Act 2010* (Cth) on 14 February 2012. The ACCC's ongoing inquiry will ultimately lead to a final access determination (***FAD***) to set the wholesale price for access to this service. Under the ACCC's Interim Access Determination (that will apply until the FAD is made), pricing for wholesale ADSL has been set which is well below the prices for the service that were previously being charged by Telstra. However, it remains uneconomic for iiNet to supply a full IPTV service to its off-net customers. If the merger is allowed to proceed (with or without the proposed undertaking) iiNet will not be in a position to provide a full IPTV service to the majority of Austar customers.

The key difference in iiNet's costs for supplying IPTV to customers for whom iiNet has a DSLAM at the relevant exchange (on-net) and supplying the same service to customers using Telstra's wholesale ADSL service (off-net) is the transmission charges. For off-net customers, iiNet must pay Telstra a monthly Aggregating Virtual Circuit Charge. This charge relates to the transmission of the total data required for the aggregated service increasing relative to content supply as more data is required to be transmitted. iiNet also incurs transmission charges for its on-net customers. However,

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[19] ACCC letter of 7 March 2012, pages 2, 3

[20] The preamble to the proposed undertakings recognises that this outcome is "likely", see section 2.3

[21] [REDACTED CIC]

the equivalent rates for these customers are lower and (more significantly) iiNet is able to use multi-casting to greatly reduce the amount of data being transmitted, which greatly reduces its transmission costs.

The following example illustrates the variance between the costs associated with supplying IPTV using the newly declared wholesale ADSL product from Telstra and the costs of supplying the same service on-net. This example demonstrates the importance of multicasting in the economics of supplying IPTV to on-net (customers connected to exchanges where iiNet has a DSLAM installed) vs off-net customers.

[REDACTED CIC]

No ability to compete with Telstra's unmetered Foxtel

It is difficult to illustrate the difference between on-net and off-net charges because the backhaul is an aggregated charge across multiple users within the exchange and is charged monthly. However, the above example clearly illustrates that IPTV using uni-casting is too bandwidth intensive to be supplied to end-users at a rate that end-users would be willing to pay. It is certainly not possible for a wholesale ADSL access seeker to supply IPTV at a rate that is competitive with Telstra's unmetered Foxtel over T-Box product (for example).

Because it is uneconomic for iiNet to provide a full IPTV service to the majority of Austar's current customers, iiNet's IPTV service will only provide very limited competition for a post-merger Foxtel in the Austar areas. High transmission costs also prevent other ISPs from providing substantial IPTV services to their off-net customers[22]. Under the counter-factual, a fully competitive Austar may enter into a bundling deal with an ISP such as iiNet. Because of the importance of a quad play offering in the current market (and increasingly so post-NBN[23]); and the fact that Austar would not have a relationship with Telstra, bundling of subscription television with telecommunications services would be reasonably likely to occur. Conversely, allowing the merger to go ahead will increase Telstra's dominance in regional telecommunications markets as the majority of subscription TV consumers in regional areas are likely to be left with little choice but to opt for a Telstra Foxtel bundle. The proposed undertaking does nothing to address the detrimental impact of the merger on regional telecommunications and subscription television markets.[24]

Telstra IPTV

Why allow Telstra to become the dominant provider in the emerging IPTV market?

In addition to Telstra's ability to offer Foxtel over T-Box on an unmetered basis using its ubiquitous telecommunications network and relationship with Foxtel, Telstra is likely to launch its own IPTV offering (as opposed to reselling Foxtel).

[22] For example TPG's website notes that TPG's IPTV product is not currently available to TPG Off-Net customers, see: http://www.tpg.com.au/iptv/. TPG's inability to economically offer high bandwidth products to off-net customers was also referred to in TPG's submission to the Wholesale ADSL inquiry, see http://www.accc.gov.au/content/index.phtml/itemId/1022756

[23] http://www.itnews.com.au/Tools/Print.aspx?CIID=280553

[24] In relation to the impact of the merger on telecommunications markets, see iiNet's previous submissions and section 7

The Commission has recognised the detrimental impact of the proposed merger on telecommunications markets[25].

The proposed merger will allow Telstra to own a 50% share of a national subscription television enterprise with a near monopoly share of the market for subscribers. The proposed undertaking makes no effort to address the very significant impact that this will have on the national telecommunications market. Given:

(a) the importance of a quad play offering; and

(b) the lack of DSLAM infrastructure in Austar areas,

for an undertaking to be effective, it needs to create a level playing field between Telstra and other ISPs in relation to Foxtel. For this reason, iiNet submits that any undertaking accepted by the ACCC must require Foxtel to allow other ISPs to obtain access to content that is equivalent to the access to content that Foxtel provides to Telstra. Equivalency of access means the same per user terms, the same content and at the same play-out quality. Without this provision, Telstra will quickly become as dominant in the IPTV market as it is in the other telecommunications markets - if not more so, given that it will likely have access to premium domestic sport.

The Convergence Review has recognised that "bundling may be anti-competitive if it reduces competition by leveraging market power from one market to another'[26]. If the merger proceeds, Telstra's ability to bundle premium content exclusively with its telecommunications content will exacerbate its dominant position in the telecommunications and media markets. The result is likely to be that prices increase, while consumer choice and innovation declines.

8. HISTORIC BACKGROUND TO THE EXISTING ANTI-COMPETITIVE ARRANGEMENTS BETWEEN FOXTEL AND AUSTAR

Historically, Foxtel and Austar have been allowed to operate under an agreement to geographically share the national market for subscription television.

iiNet does not have access to the details of Foxtel and Austar's agreement to share the national market for subscription television[27]. However it seems to be an agreement that continues beyond the expiry of historic factors. For example, Telstra offers Foxtel over a T-Box, a product that is delivered over the internet (so the fact that Foxtel and Austar own distribution infrastructure in different areas is irrelevant). Despite having excellent national coverage with its cable and ADSL2+ services, Telstra restricts its offer of Foxtel over T-Box to "areas where Foxtel is available". This restriction seems related to Foxtel and Austar's agreement not to provide competitive services within each others geographic areas.

[25] See paragraph 48 of the ACCC's Statement of Issues; also page 2 of the Market Inquiries letter from the ACCC dated 7 March 2012 and section 2.3 of the proposed undertaking

[26] DBCDE, Convergence Reviw - Discussion Paper: Media Diversity, Competition and Market Sructure, 19 September 2011, p 28

[27] In iiNet's submission in response to the ACCC's Statement of Issues, iiNet suggested that the source of this arrangement between the merger parties might be the Channel Sub-licensing Agreement under which Foxtel gives Austar "exclusive rights to supply and sub-licence certain channels in Austar areas". See "Emerging Market Structures in the Communications Sector", June 2003, p 82

In the counter-factual Foxtel and Austar would compete

Even if the reasons for the merger parties historic geographic sharing of the national market are purely related to the location of their distribution infrastructure, the ACCC's assessment of the counterfactual should assume that this arrangement will change in the near future. During the term of the proposed undertaking the NBN will gradually expand its coverage to become all but ubiquitous (with Telstra to migrate all of its wholesale service to the NBN by 2018). To the extent that geographic market sharing between the parties is based purely on distribution infrastructure, the NBN will provide access to wholesale products that will allow the parties to compete in each other's regions. It should also be assumed that a fully competitive Austar and Foxtel would compete with each other for content and would therefore be unlikely to offer the extremely similar content packages that they do today. The counterfactual should assume that Foxtel and Austar will compete with each other for the acquisition of content.

It is apparent from the statements in relation to sports content (referred to above in section 4) that the merger parties have argued (and possibly that the ACCC is tempted to accept) that it is inappropriate for existing problems in the market for content acquisition to be addressed by the proposed undertaking. To the extant that the existing lack of competition in this market can be attributed to the anti-competitive relationship between the merger parties that has been allowed to exist for a number of years, iiNet submits that this argument cannot be accepted. It should be assumed that under the counter-factual, Foxtel and Austar will compete with each other on a national basis.

9. IMPORTANCE OF SCALE AND PRODUCT DIFFERENTIATION POST-NBN

ISPs need scale to compete with Telstra in the NBN world

Now is not a good time to create a subscription television behemoth (if there ever was a good time). As far back as 2003, the ACCC recognised the importance of access to pay TV content for the development of new broadband networks[28].

iiNet recently purchased South Australian based ISP, Internode. Simon Hackett, Internode's founder and managing director, is continuing in his position as Internode's managing director. In explaining the reasons behind the merger of the two ISPs, Simon Hackett has been quoted as saying:

> The next decade is going to be one in which the consolidation of the market and the pressure on operating margins driven by competition will put more and more pressure on market players to be extremely efficient in terms of overheads per customer. There is only one way to do that – with very high operating scale.[29]

The design of the NBN means that in order to have a national service offering, ISPs need to commit around:

> $20 million per annum to operate and 'empty network' on the NBN once the NBN has all of its 121 points of interconnect deployed… That running cost is

[28] ACCC, Emerging market structures in the communications sector, A report to Senator Alston, Minister for Communications, Information Technology and the Arts, June 2003, p 78

[29] http://www.theregister.co.uk/2011/12/27/hackett_manifesto/

> just the price of admission, the price to run an empty network, before you add a single customer to it.[30]

Other industry participants, analysts and commentators have made similar observations:

> With organic growth expected to become a minor theme for telcos this year and beyond, analysts say customers will now be won through acquisitions or through superior customer service initiatives and new product offerings.
>
> The importance of scale cannot be underestimated in the NBN world. That's because in an NBN environment shrinking margins and the high costs required to deliver nationwide broadband services will mean telcos with big customer bases will be best positioned to spread the access expenses and contain costs.[31]

Adding to Telstra's scale substantially lessens competition

In an environment where ISPs are going to rely on scale in order to compete, the ACCC is being asked to allow a merger to go through that will massively increase Telstra's market power by effectively giving it a 50% stake in a nationwide near monopoly over subscription television. The proposed undertaking does nothing to address the impact of the merger on telecommunications markets, an impact that has been previously recognised by the ACCC in the context of this merger:

> The ACCC considers that:
>
> - Telstra's Telstra's ownership of 50% of FOXTEL is likely to limit the development of competition in markets for the supply of fixed broadband and fixed voice services; and
> - Telstra, by virtue of its shareholder relationship with FOXTEL, would be likely to obtain preferential access to content acquired by FOXTEL and the proposed acquisition would extend this advantage to the distinct geographic areas serviced by AUSTAR[32].

The undertaking does nothing to address the increase to Telstra's scale

The proposed undertaking does nothing to address these legitimate concerns. The proposed merger would allow Telstra access to (as well as a 50% share of) a national subscription television offering with exclusive access to all the content that drives subscriber growth. When this unique benefit to Telstra is added to the other three limbs of its quad play offering, namely:

(a) ubiquitous mobile coverage;

(b) a lower wholesale cost for delivery of carriage services (because it will retain its backhaul network even after the Structural Separation Undertaking comes into effect); and

(c) its ongoing advantage in the voice market due to its history as an incumbent monopolist,

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[30] ibid

[31] http://www.theaustralian.com.au/business/companies/nbn-a-catalyst-for-acquisitions-in-a-saturated-telco-market/story-fn91v9q3-1226235971979

[32] Letter from ACCC dated 7 March 2012, page 2

the damage that will be done to the national telecommunications market by this merger should be apparent. Telstra's scale coupled with its unique access to premium content through its relationship with the merged entity will be particularly detrimental to competition as the NBN's coverage increases.

Telstra's control over content will add to its dominance in an NBN world

The ACCC is being asked to approve this merger in an environment where the importance of service differentiation through the ability to offer premium content will be paramount as ISPs move towards more uniform carriage delivery.

The construction of the National Broadband Network levels the playing field in terms of the carriage services that will be supplied by ISPs. As important as premium content is in the current market, it will become more and more crucial as the NBN roll-out progresses. With similar carriage services and similar wholesale prices (with the exception of Telstra retaining the benefit of low transmission costs, having been allowed to keep its backhaul network), ISPs will be relying on content to differentiate themselves within the telecommunications market.[33]

10. LACK OF TRANSPARENCY IN THE MERGER REVIEW PROCESS & LACK OF INFORMATION IN RELATION TO EXCLUSIVE CONTENT AGREEMENTS

No information concerning the expiry dates of Foxtel's existing exclusive contracts

On 13 March 2012, iiNet wrote to the ACCC requesting access to details of Foxtel's existing exclusive access arrangements with content providers. On 16 March 2012, the ACCC responded to that request stating that it was not in a position to provide details of the exclusive arrangements due to confidentiality concerns (but it did disclose that the proposed undertaking will not expire until four years after the expiry of the last of Foxtel's existing exclusive agreements).

The proposed undertaking:

(a) restricts Foxtel's ability to enter into exclusive content acquisition arrangements in relation to a narrow sub-set of the content Foxtel currently provides to its subscribers; and

(b) does not have any impact on Foxtel's existing exclusive agreements.

It is impossible for iiNet to know when Foxtel's existing exclusive content agreements expire as these agreements are apparently confidential. Not only does this make it difficult for iiNet to comment on the effectiveness of the proposed undertaking (what if the exclusivity on the best content runs for half of the term of the undertaking?), it also means that these provisions are unlikely to assist Foxtel's competitors to gain access to this content for the duration of the proposed undertaking if it is agreed to, because it will be impossible for iiNet to discover when they expire. It is unlikely that Foxtel will ever agree to disclose the expiry dates of its exclusive content agreements if it is not willing to do so to facilitate the merger review process. This will make planning and negotiating for access to this content very difficult if not impossible.

[33] http://www.itnews.com.au/Tools/Print.aspx?CIID=280553

No information concerning Foxtel's affiliations

In addition, the provisions in the proposed undertaking, that restrict the content that the proposed undertaking applies to, rely on knowledge of the corporate structure of the various entities related to Foxtel and other content owners in order to ascertain exactly what content the proposed undertaking applies to.

These problems will continue if the proposed undertaking is accepted, as new entrants and existing smaller competitors of the merged firm attempt to navigate their way through the undertaking. If the proposed undertaking is accepted Foxtel will again refuse to allow access to the relevant agreements (or even to give an indication of their expiry dates), notwithstanding iiNet's offer to sign confidentiality undertakings and restrict the personnel to whom information would be disclosed. It is unlikely that content providers will be any more willing to disclose this information to parties seeking access to content covered by the proposed undertaking, particularly if they have genuine confidentiality obligations to Foxtel.

Lack of transparency in merger review process

iiNet also has concerns regarding the transparency of the current informal merger review process. iiNet does not accept that there can be valid confidentiality concerns with the entirety of each of the merger parties' submissions. Particularly given that iiNet has stated to the Commission that it is willing to submit to a confidentiality regime (which could include personal confidentiality undertakings and disclosure only to legal and regulatory personnel, as has been the case with other, equally sensitive ACCC processes).

No evidence to support any change of view by the ACCC

The proposed undertaking is inconsistent with the views previously expressed by the ACCC (including some of the views expressed in the preamble to the undertaking itself). The proposed undertaking ignores:

(a) the need to address the impact of the merger on telecommunications markets[34];

(b) the need to address access to sporting content;

(c) difficulties faced by IPTV providers when dealing with content providers, such as minimum subscriber guarantees[35]; and

(d) the need to address the national market for subscription television[36], not just the tiny (though admittedly growing) IPTV subset of that market.

iiNet assumes that the ACCC sees some merit in the reasoning put forward by the merger parties to justify this change in the approach that they are asking the ACCC to take to the merger. A fair and transparent process would allow iiNet to respond to these justifications.

[34] See paragraph 48 of the ACCC's Statement of Issues; also page 2 of the Market Inquiries letter from the ACCC dated 7 March 2012 and section 2.3 of the proposed undertaking
[35] See paragraph 58 of the ACCC Statement of Issues
[36] See paragraph 50 of the ACCC Statement of Issues

11. RESPONSES TO COMMISSION'S SPECIFIC QUESTIONS

iiNet's responses to the specific issues on which the Commission has sought a response are attached.

Yours faithfully

Stephen Dalby
Chief Regulatory Officer
iiNet
ph: +618 9213 1371
email: sdalby@staff.iinet.net.au

Peter Lee
General Manager
Strategy, Wholesale & Regulatory Affairs
TransACT
ph: +612 6229 8144
email: Peter.Lee@transact.com.au