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FOXTEL/Austar merger

Pay TV merger policy by political forecasting

The proposed acquisition of Austar by FOXTEL appears to be raising concern within the Australian Competition and Consumer Commission (ACCC). Its Statement of Issues (22 July 2011) identifies a number of potential competition problems which in the ACCC's view may lead to a substantial lessening of competition, and hence the prospect that it may block the acquisition.

The Issues

The ACCC's principal concerns are that the acquisition would "effectively create a near monopoly subscription television provider across Australia", increase the new entity's market power in the market for the acquisition of programming, and reduce the potential competitive pressures in the telecommunications market. These are not unnatural concerns given that FOXTEL and Austar are the two largest pay TV operators.

But there is something missing from these observations which make them a shaky basis for concluding that the proposed acquisition is likely to substantially lessen competition. This relates to the present, and the future.

The Present Arrangements

Australian pay TV today is the product of a past bloodbath in the battle between technologies, operators, programming and for subscribers. This has seen investors lose substantial sums of money based on winner takes all competition that has weakened all and destroyed some of the participants. As a result today there is a mix of competition and cooperation between pay TV operators - FOXTEL provides the bulk of key programming to Austar, and they operate in different geographical areas apart from the Gold Coast. Thus under the present arrangements there is limited competition for programming and subscribers.

This is a truce condoned by the regulator. Like it or not the reason for this must be clearly understood. It is simply that the Australian pay TV market would not be the competitive ideal suggested by the ACCC if there were outright competition between FOXTEL and Austar. The failure of pay TV operator Australis in 1999, and the financial disaster of Optus illustrate this.

The Australian Merger Test

Under Australian competition law a merger will be blocked if it significantly lessens competition. This is determined by the so called "with and without test" under section 50 of the *Competition and Consumer Act 2010*. This requires the ACCC to consider the effects of the transaction by comparing the likely competitive situation with a merged entity (the "with" part) to the likely competitive environment if there is no merged entity (the "without" part). The latter is referred to as the counterfactual; or the comparator.

Typically the "without" part, or counterfactual, is the continuance of the *status quo ante*. That is one asks whether the proposed transaction would lead to less competition for subscribers and programming compared to the situation today. Under this counterfactual the proposed acquisition will, in my view, have limited competitive impact for the reasons already given.

The counterfactual is NBN

But the ACCC says that this is not the appropriate counterfactual. Its counterfactual is one where the future competition between FOXTEL and Austar will be enhanced by something called the NBN i.e. the National Broadband Network.

The NBN is a state sponsored, owned and funded fibre-to-the-home (FTTH) and wireless/satellite high speed national broadband network which will provide open access for pay TV, telecom and other service operators at regulated prices.

But there is more. The Federal government proposes to buy and decommission the existing wire and off air networks i.e. Telstra's twisted copper wire telephone network and two HFC cable networks, as the NBN rolls out. This policy is premised on the assumption that NBN is future-proof technology even if it is not commercially viable. Given the Governments' poor record in predicting the near future let alone the next quarter century, this is at best a highly questionable assumption. But the elimination of network competition takes this faith in political forecasting to a new level of delusion.

The Government's political forecast now appears to be guiding Australian merger policy. The ACCC plans to engage in some risky crystal ball gazing, namely how FOXTEL and Austar will compete in this counterfactual world. To quote (para 28):

> In assessing the effects on competition of the proposed acquisition, it is necessary to consider the extent to which FOXTEL and Austar would be likely to compete in the foreseeable future under the counterfactual. The extent to which FOXTEL and Austar compete currently, or have competed in the past, is not necessarily indicative of the likely future level of competition between the parties. This may particularly be so in light of significant industry changes which are likely to occur in the foreseeable future, most notably the rollout of the NBN, which has the potential to facilitate entry by FOXTEL, Austar and other parties into areas of new activity (either in the sense of providing different products and/or expanding their geographic presence).

Some criticisms

Typically such a counterfactual – the prospect of reduced entry barriers and greater access - would reduce the concerns of a regulator as it suggests greater potential competition. The ACCC looks at it the other way – the ability of an enhanced FOXTEL to acquire the best programming runs the risk of foreclosing the pay TV and telecom markets.

The ACCC's counterfactual is predicated on two assumptions that the NBN a) will encourage vigorous direct competition between FOXTEL and Austar; and b) that they and other competitors will flourish.

However we have sufficient experience with pay TV markets to know that this is not the only counterfactual. An alternative, and more plausible counterfactual is that direct competition between pay TV operators especially where there is an asymmetry in their size in terms of programming and subscriber numbers, may lead to less not more eventual competition, because one inevitably goes to the wall. This is because they are enticed into winner-takes-all strategies.

The last time the ACCC blocked a major pay TV merger it resulted in an own goal as Australis, the major competitor to FOXTEL collapsed, FOXTEL then picked up its key programming (movies) on the cheap, and Optus eventually withdrew from the unprofitable pay TV channel market by reselling FOXTEL channels (see my *Pay TV in Australia*, IPA., 1999, and 'The Foxtel/Australis Merger', *Australian Business Law Review*, 2000). The ACCC's then theory of competition (its counterfactual) was that by blocking the acquisition Optus would thrive as a competitor to FOXTEL, failed to take into account the way competition actually operates in pay TV markets. We now better understand the nature and consequences of the network effects which operate in industries such as pay TV.

There is another concern. The ACCC's counterfactual is driven by a government sponsored investment project (to the official tune over $40b which many put considerably higher) which has yet to be realised, is politically controversial, and which if it had itself been subject to a competition test would not see have seen the light of day. The ACCC is now treating this "market" as a regulatory given upon which to base its application of Australian merger law. In Europe those who drafted competition law had the sense to also subject government funding and support for firms and projects to a competition test to ensure that they did not distort competition (Art. 107TFEU). This is not law in Australia but the principle seems to have been totally abandoned.

The conclusion

Compared to the *status quo ante* the proposed merger is unlikely to significantly lessen competition. The ACCC's counterfactual that the NBN will trigger direct and sustainable competition between FOXTEL and Austar is the least likely of several outcomes. The most likely is that any such competition will lead to a messy consolidation of pay TV operations with an eventual structure little different from the proposed acquisition. Which if correct suggests that the ACCC's counterfactual is that the proposed acquisition will not significantly lessen competition.

I readily accept that the analysis required to address fully the issues raised is more complex than portrayed above. But the use of a counterfactual based on the ACCC's speculation as to the future course of government policy, and unknown technological developments is a questionable basis for sound merger policy.

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