COMMENT ON THE AT&T PROPOSAL TO BUY DIRECTV[1]

Should Australians be interested in the outcome of the bid by an American company with a long history of dominating global telecommunications markets[2] to acquire another American company that dominates satellite broadcasting in the USA and Latin America?[3] Yes, Australians should be interested. According to CNN News, "if regulators approve the deal, AT&T would lord over a nationwide wireless, landline telephone and satellite TV network as well as a large fibre-optic cable network." That would allow AT&T to control the flow of content to any audio-visual screen almost anywhere in the USA. Moreover, this proposal comes on top of a previous one by Comcast for Time-Warner Cable.[4] But, you might say: all of that applies to *them*, not to us. Wrong. It also applies to a globalised world generally, but perhaps not in the same degree for each sovereign state in that globalised world.

For us, Screen Australia's report, "Convergence 2011: Australian Content State of Play," provided part of the reason to be concerned. It examined the local content within the more than six billion dollar free-to-air and subscription television sector. The overall conclusion is that Australia is doing well in supplying local content, but with a declining market share. The focus in this comment is on the nature of this decline and whether regulatory decisions by the designated authority in the US are likely to contribute to a further decline.

The dilemma facing Australia was captured in Screen Australia's report: "the cost to Australian suppliers in bringing locally produced drama to the screen is greater than the cost of purchasing content from US producers.[5] It follows that ratings for Australian programs would need to be higher in order to generate an equivalent advertising revenue-return." Although the linkage between viewers' preferences (via the ratings) and the greater

[1] Michael J De La Merced, "AT&T Is Said to Be Near a Deal to Buy DirecTV', *The New York Times*, 17 May 2014. Available at: http://dealbook.nytimes.com/2014/05/17/att-said-near-a-deal-for-directv/.

[2] For a history of AT&T refer to http://en.wikipedia.org/wiki/At%26t.

[3] DirecTV transmits digital satellite television and audio to households in the United States, Latin America and the Caribbean. Refer to http://en.wikipedia.org/wiki/DirecTV.

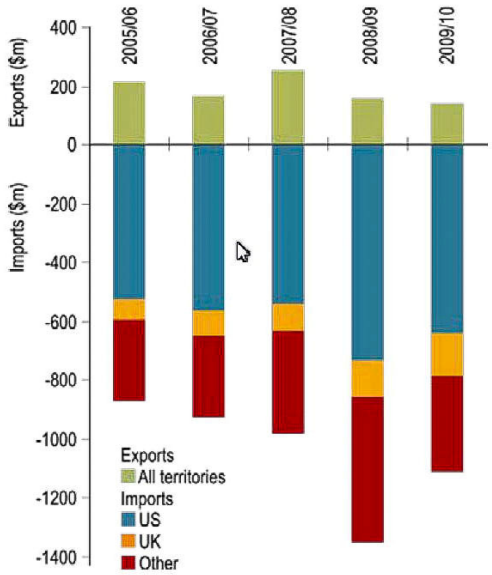
[4] David Gelles, "In a Matter of Weeks, Meeting of Minds on Cable Giant's Deal," *The New York Times*, 13 February 2014. Available at: http://dealbook.nytimes.com/2014/02/13/time-warner-cable-and-comcast-strike-45-2-billion-deal/?_php=true&_type=blogs&_r=0.

[5] A one-hour, newly released drama program for free-to-air television typically costs between A$2.5 million and A$5 million to produce in the US and can be used by an Australian broadcaster for a license fee of between A$100,000 and A$400,000. Production of approximately equivalent drama programs in Australia costs between A$400,000 to A$1.8 million to produce and are available to Australian broadcasters via license fees, presales, equity investments or other arrangements of between A$350,00 and A$1.4 million. Increased concentration in the American broadcasting market will most probably not substantially change these cost ranges. Refer to Screen Australia, "Convergence 2011: Australian Content State of Play," August 2011.

economies of scale[6] available to US producers of similar content are not likely to be changed substantially with increased market control over broadcasting in the US, the negotiated outcome for Australian broadcasters nevertheless depends at least partly upon the existence of a number of competing producers and holders of distribution rights for US productions. If the increased concentration in broadcasting in the US leads also to a greater concentration in control of distribution outside the US, then licence fees may rise. This could be an advantage for Australian content producers, but it could also lead to restrictive choices via bundles of programs containing some that are well rated in Australia and an assortment of not-so-popular ones. This could then lead to ineffective and inefficient allocations of available financial resources for audio-visual content in Australia.[7]

In addition to the possibility that the merger in question leads to undesired quantity/quality choices for Australian content users (or higher than necessary licence fees that must be recovered by Australian broadcasters), increased concentration in the US market for supply and distribution of audio-visual content could alter the recent trends in Australian imports and exports of audio-visual content. Screen Australia presented data for incoming and outgoing royalties arising from cinema, television, video and multimedia releases from 1991-92 to 2001-12, some of which were previously unpublished by the Australian Bureau of Statistics.

Chart 1: Australian Royalty Trade in Cinema, Television, Video and other Multimedia Releases.



Source: Cited in footnote 5 above, a location at which data tables are available. The chart is a slightly altered (software enhanced) version of the original on page 24.

[6] The larger scale of production in the US apparently affects both the quality and the quantity of productions rather than their unit cost, but the greater through-put of programs results in a lower license fees for Australian broadcasters.

[7] This is similar to the "bundles" of channels available with subscription television and to "bundles" of Internet access arrangements. With these, users typically pay for what is not wanted in order to get what is wanted, and it usually benefits the supplier more than the consumer by arranging for the user to purchase more than would otherwise be requested, with little or no reduction in the cost of supplying the content. In certain cases such a reduction could occur, but it is not certain whether a majority of subscribers would benefit from it.

Chart 1 on the previous page shows that Australian royalties received for audio-visual material (exports of royalty trade) increased in the period from 2000-1010 to 2011-2012 from A$141 million to A$189 million, a rise of A$48 million. But royalties paid (imports of royalty trade) increased by a greater amount in that period from A$1107 million to A1254 million or A$147 million. A continuation of this trend is therefore likely to result in an increasing royalty gap. A likely effect of increased concentration in the American market for audio-visual content is to offer a range of bundles that is aimed at the mass market, which as noted above could suit some subscribers but probably not all.

The precise way in which Australian audiences will be effected by the proposed merger cannot therefore be known until the American regulator decides what conditions, if any, are to be placed on AT&T for the acquisition to be approved, and until adjustments are made to the resulting market conditions. It is nevertheless clear that the bargaining power of Australian broadcasters is not likely to be enhanced by increased concentration among American audio-visual content suppliers. Increased market power generally results in focusing initially on the larger transactions and, following that, on an exploitation of marketing possibilities from those representing smaller purchasers of broadcasting licences. The larger transactions thereof set the pattern.

The principal purpose of this comment is to suggest that we cannot be certain that American regulators will take into consideration the impact of their decision on Australia. There is no legal requirement that they should do so. Therein lies much of the problem. Regulatory agencies in the Unites States were designed to have great virtues. Their members were intended either to be or to become experts in a particular field of regulation, to be free of the formalities of law courts[8] and to initiate corrective action. They could make up new rules as they see fit and do everything within a specific area that the legislative, executive and judicial branches of government achieve within a wider framework:

> A [US] regulatory commission is immune from the principle of separation of powers. Worse, within its own domain, a regulatory commission acts as plaintiff, prosecutor and judge in its own case -- a status not enjoyed elsewhere in the adversary system of justice.[9]

The system was designed for expediency and in achieving that it sometimes failed to realise the outcomes that were visualised at each commission's inception. Expecting these regulators to resolve issues experienced in the part of the world that lies outside US sovereign territory is expecting something that is well beyond those visualisations. Yet, those same regulators have a substantial impact on the outside world as a result of the globalisation process that was nurtured largely by US corporations with visible assistance by the US government. The relevant regulators have sufficient flexibility to give due

[8] Their decisions are of course subject to appeal within the judicial system, but until then their decisions are exposed only to public debate and to the possibility of legislative amendment.

[9] William Letwin, *Law and Economic Policy in America*, University of Chicago Press, 1956, p. 280.

consideration to the interests of the "outside world," but they need to know what those interests are. It is up to us to communicate our specific interests to them.[10]

John Zerby
23 May 2014
j.zerby@bigpond.com

[10] It is desirable to do this early in the regulator's investigative process, as monitoring tasks after a decision has been reached are not given a high priority. Moreover subsequent changes may require court enforcement on a continuing basis. See prepared statement of Hon. Joel Klein, Assistant Attorney General, Antitrust Division, US Department of Justice, Hearings before the Committee Commerce, Science and Transportation, United States Senate, 27 July 2000. Available at: http://www.gpo.gov/fdsys/pkg/CHRG-106shrg84450/html/CHRG-106shrg84450.htm.