PROF SNAPE: We're resuming and we welcome Fairfax. We have two representatives at the table there and we'd ask you in the normal way to introduce yourselves for the transcript.

PROF HILMER: Thank you, I'm Fred Hilmer, chief executive of John Fairfax Holdings Ltd.

MR RANEBERG: My name is Dale Raneberg, I'm a principal with the management consulting firm AT Kearney.

PROF SNAPE: Thanks very much. I think, Mr Hilmer, you're going to start the ball rolling.

PROF HILMER: Thank you chairman and Mr Simson for the opportunity to appear today. What we would like to do is take 10 or 15 minutes and give you some remarks that I think flow from the draft report and some of the discussions subsequently and then we would be pleased to have a dialogue and answer questions. As we said publicly, we welcome the draft report and the recommendations. We thought it took what was a refreshingly pro-competitive stance which is I think an area that has been characterised by oligopoly really requires. In that respect it really broke new ground. The heart of our submission that we put to you last time was that convergence in a digital world means that all communication in whatever form can be digital.

Therefore it was the availability and access to digital platforms that was really going to be critical in the 21st century. It was in that context that we proposed an ending of the cross-media and ownership issues provided that a competition regime could be brought into play to basically promote what we think are the real objectives of media policy. We at the same time signalled - and we were pleased to see it picked up - that the devil is in the detail, that the sequencing and timing of change and the way in which processes would make change occur were absolutely critical. You recognised that and you also I think called for a fairly - a carefully sequenced approach. We'll come back to that a little later, if I could, in my remarks and add some suggestions.

Basically you called for an end to cross-media limits when a number of conditions were met, firstly, an end to limitations on television stations, licences; secondly that more spectrum is made available for broadcasters which we interpreted to include datacasters as well; that foreign investment limits are repealed, which is something that we supported; fourthly, that the Trade Practices Act be reviewed and monitored in terms of its appropriateness to provide the competition that we believe that a good industry will require, so something like a wait and see approach, given that there was a phasing, you would be able to see how the Trade Practices Act played itself out. We believe that those measures, coupled with the application of an access regime to these various broad band platforms would give us the sequencing essential to deregulation and as I say we'd like to come back to one or two points on that.

Your report was hailed as pro-competitive and I think we're hopeful to see that that approach is taken to media regulation. It's somewhat amusing to us that in recent weeks we've seen widespread approval for a new entrant in the physical airways. When Branson proposed the extension of Virgin here we didn't see any lobbying by incumbent licensees. We didn't hear anything from anyone in the government other than approval that this was a good thing and we'd like to see the same principles extended to the electronics to the aether as is extended to the airways. We don't see why we can't have full competition in the skies but not in the aether above our homes. In fact we thought that if we'd renamed Fairfax, Virgin Airways, we might have even had a shot at being given a television licence.

More seriously, what I'd like to do then is come back to three issues that I think flowed from the report. The first is how the Trade Practices Act might be used and evolved to protect and promote diversity in competition; the second is just a few comments on an access regime for digital pipes, and the third, which I'll ask Mr Raneberg to comment on, is the process and economics of early spectrum release. Then I'd just like to come back and give some concluding thoughts on some immediate steps that we believe would progress this matter. So let me first turn to the use of the Trade Practices Act. I think what we proposed last time was a wait and see and I think you endorsed that, although it's something we might like to discuss. We were not keen to see a public interest test inserted into the act immediately. We wanted to see whether market definitions would not evolve in a way that would make the requirement of such a test superfluous. I think a test like that carries its own dangers.

We also would make the point to you that in the authorisation procedure that currently exists in relation to section 50 - the mergers section - the public interest test can be used to allow mergers but it can't be used to prevent them. So you'd be using public interest in a way that is really quite unfamiliar in the current competition framework. We think that as this market evolves we would like to see how market definitions evolve. If market definitions evolve in the way that recognises the economic reality of convergence, then you don't need a public interest test as a potential bar to mergers, which as I say is quite a step in terms of a competition approach.

We do think it's unlikely that concepts like the market for ideas or the market for people's scarce time can be translated effectively into a competition framework; and a competition framework, I think as you pointed out in your draft report, is really about substitutability and the impact of purchasing decisions or pricing decisions in one sector on another sector. I think at the end of the day they're concepts that will work here as convergence proceeds.

The second point I wanted to make a few comments on is the access regime for digital pipes. We noticed in section 8.7 that you talked about that. You talked about the issue of access to essential services. We note - and I think we pointed out last time - there is an access regime in section 44B of the Trade Practices Act. We think it's quite broadly defined in that act. It certainly can cover the kinds of services that would be covered by pretty well any of the current digital delivery pipes that exist or are being contemplated, and you appeared to take a similar view as was taken with regard to the issue of defining markets which is, "Let's wait and see how that evolves." It is a new area, it's only currently being tested, but as we look at it we would put the view that we should also again see how this evolves and there seems to be adequate scope there to provide a framework that's going to encourage people to sit down and have realistic negotiations about access, because ultimately that's what it's about. You don't want to get an environment where every time you want to do a commercial transaction you're running off to a regulator.

We also would observe that access may be of less significance if spectrum is more widely available as we and others are advocating and we think there is scope then for this regime to work and to apply to cables, to satellites and even to broadcasting spectrum. These issues are all interwoven with the immediate policy question, I think the first test of a new approach to media which is around datacasting. We thought after you had really opened the invitation in your report for people to think about early release that it would be useful to actually have some hard economic data on the economics of early release and the benefits of various policy choices. To that end we commissioned Kearneys to study the cost and benefit of early release. They found a clear net economic gain if we could accelerate the transition to digital.

The other side of the equation which is not dealt with as fully in their report but I think is sort of below the surface is that a failure to release early and an insistence by the government on a constraining approach to datacasting is going to accelerate the development of alternate technologies and could have the impact of seriously devaluing spectrum were the sale to take place at a later date, because other technologies aren't just going to sit around and be kept on a shelf. So let me at this point hand over to Dale Raneberg of A.T. Kearney to just make a few comments on the basis of his report, which we've sent to you.

MR RANEBERG: Thank you very much, Mr Chairman, Mr Simson. To just add to the comment that Fred Hilmer just made about how the spectrum may devalue over time, there's also the foregone commerce. What we've got her modelled is the opportunity cost of having a simulcast period, and so there's commerce that can take place using the spectrum in the meantime.

So I want to talk about the benefits that we've calculated. These are preliminary estimates and they're for an early release of the spectrum and it's a starting point, we think. It's given us an indication that there are benefits from leasing the spectrum early and connecting everyone and that there's hence reason to go into more detail. We initiated our look at this looking at the expectation of low penetration, therefore a long simulcast. We anticipated the simulcast period would go for something beyond 10 years. So our calculations have assumed that the opportunity cost is at minimum 10 years, 10 years of using the spectrum for analog simulcast. So it's only the value of additional services during that 10-year period, not beyond. These services if they come on, of course, will have longer value.

The costs which we've used, the costs are building a digitally capable network from the first day of that 10-year period, and so the costs of course will establish infrastructure which will go on beyond the 10-year period that we've looked at the opportunity cost. I might just direct you to exhibit 9 and the submission. Exhibit 9 looked at the value of the current market capitalisation and licences as a value for the spectrum in its current use. We looked at Channel 7's market capitalisation, the book value of its licences, Channel 9's and Channel 10's and we worked out some averages. You'll note that there's a footnote on Channel 9's market capitalisation. We've only taken 55 per cent of their market cap because that's the proportion of their revenue which they derive from broadcasting, and of course their value has blown out with speculation about their future floats on online services and the float that they have had. You'll see that approximately - reasonably rough numbers, but 1.3 billion average market capitalisation and the book value of the licence is around $1 billion.

PROF SNAPE: I think that's gone up significantly in at least one case since that data.

MR RANEBERG: That's right. In Channel 7's case that's gone up substantially.

PROF SNAPE: I think it has about doubled.

MR RANEBERG: The question then was, were these reasonable estimates for increased services using additional spectrum. We've described it in the submission but I'll just refer you to how much the licences and market capitalisation have increased over the last five years, the period during which pay TV services have been introduced into Australia; something in excess of 60 unique channels brought onto the market, and during that period of course the media sector has outpaced the all ordinaries.

We've also taken some evidence from the United States and we've shown that in exhibit 10. This is evidence of the growth in advertising revenue for television and as pay TV channels and then we've compared it to the growth in advertising revenue for free-to-air TV networks. You'll see across the bottom of that exhibit on the left-hand side the number of channels has grown from 1980, 26 channels to 1999, 69 channels. During that period we've had an annual average growth of 8 per cent, so the advertising revenue has risen from 11.5 billion to 50 billion in 1999. In the same period the free-to-air networks achieved 6 per cent annual growth. This gave us some confidence that you could actually add new services and not affect detrimentally the existing broadcasters. We haven't included it in this report, but also the fifth channel in the UK grew the advertising market in the UK as well.

Our calculations for potential value from releasing spectrum - and you'll remember from our report we weren't very aggressive in what spectrum could be released. We worked on the basis of a potential current use of 168 megahertz per region. Their own report said that that would be up to 350 megahertz per region. We worked on the basis of 168 and assumed that 75 per cent of the spectrum would be available for release on conversation to digital. Our calculations for advertising revenue that could be generated from using that spectrum for additional services is 2.5 billion over a 10-year period, so that's the opportunity cost of using it for analog simulcast. I can take you just briefly through that calculation if you like.

PROF SNAPE: I think we've got it here. We might query it later.

MR RANEBERG: Okay. We also looked at subscription services, assuming that we'd be able to have not only traditional media and traditional types of revenue for advertising but also subscription services and online commerce and transactions. We also looked at subscriptions, and the amount we calculated for subscription services over the 10-year period was approximately 450 million. For online commerce and transactions it was 1.3 billion.

I just make a point about advertising, one last point. It's interesting that part of that 2.5 billion would be a growth in the advertising market if we follow the US trend. Part would also be a shift in the advertising mix. Perhaps it's away from sponsorships, perhaps it's away from using other types of advertising, billboards or direct mail, but it's not all incremental advertising spend. Part of it would be a shift in the mix, would be the introduction of the infotainment and advertorial type program en masse. That calculation of those three types of services - advertising, subscription, online commerce and transaction, gave us a total benefit of 4.3 billion over the 10-year period.

We also were able to get a quote for a standard definition set-top box. This is a landed quote but it's a wholesale quote, and we're assuming that with a scheme that would generate revenue and be able to distribute those boxes around Australia there would be I'm sure a better price than the retail price available. That's approximately $300 per box. We've assumed in our calculation, because we know that a lot of Australian households have more than one TV, that for every Australian household that has two TVs they get two boxes. Beyond that no, but up to two TVs they get a box for each TV. We've also assumed that for half the boxes they'll need to be installed and we've budgeted $100 installation - reasonably aggressive, and we'd assume that if boxes were made available readily some people would come in and install them themselves. So we've assumed that only half the boxes would need to be installed. That would cost $100. Total cost of that roll-out of standard definition set-top boxes is 3.7 billion.

PROF SNAPE: You said $100. $50 you've got in paragraph 91.

MR RANEBERG: Yes, $100 for every second box or $50 on average for every box.

PROF SNAPE: Okay.

MR RANEBERG: So between the 4.3 benefit over the 10-year period, the opportunity cost of the simulcast period over 10 years and the cost of providing access to that spectrum, there's a difference of just over half a billion dollars. I'm happy to answer any questions in detail about those calculations. I've got the calculations here if you'd like to look at them.

PROF HILMER: Thanks, Dale. I think we can get into this in discussion, but the 3.7 is a fairly generous approach to facilitating a conversation and there would be really a worst case figure. So we think that there are some immediate steps that can be taken to advance reform and that we would like to discuss with you in terms of the sequencing and timing. We think firstly to build on the ideas in the A.T. Kearney report, to accelerate the hand-back and freeing up of the spectrum used for analog TV is very significant, because there's so much spectrum there.

Secondly, we applaud the idea of a phased approach. I guess one idea we'd like to put on the table is: why not have an immediate end to cross-media with respect to radio, go beyond removing the restriction to two licences per area? That would have the advantage of allowing the Trade Practices Act to be immediately brought into play in terms of market definition and you could get a better sense and regulators could get a better sense of how this was going to work. We think that that's a relatively uncontroversial step in the direction that could be taken immediately. Thirdly, as we said in our submission - and we certainly did not intend it to be conditional, although you mentioned this on page 167 - you could remove the foreign ownership restrictions on media to the extent they're special to media right away.

Finally, with respect to datacasting, we note that this is an interesting and early test of media policy. There are really three issues: getting more spectrum available through such moves as the free-up, getting more access to more spectrum by new players, which we think is very pro-competitive; and doing that with the definition of datacasting that allows some viable commercial opportunities to emerge, as I think you've recognised. From our perspective what we want to see here is changes that are good for consumers in terms of cost and affordability for digital television that doesn't mandate anything in particular but lets consumers and technology suppliers, in fact let's the market, choose; that is good in terms of allowing new services to emerge; that's good for the population in general, wherever they live, bush, different areas of the cities, to get access through the best and most widely available pipe; and is good for investment, jobs and growth by really stimulating and supporting the very dynamic contribution that is already being made through media and communication.

I think that the government itself in a recent report has acknowledged that as a real spur to economic growth. We look forward to seeing how the government deals with these issues and we look forward to further discussion with you and to your final report. Thank you.

PROF SNAPE: Thanks very much for your thoughtful submission and for that very helpful exposition. We may come back to some of the details of the calculations in a moment, but on to some more general issues perhaps to start with. As you noted, we have maintained a distinction in our draft report between datacasters and broadcasters, and if no distinction were there between datacasters and broadcasters then presumably the cross-media rules and also the content requirements would apply to datacasting or what is envisaged as datacasting. So we maintained a distinction so in fact those requirements on broadcasting services would not be attached to what is envisaged as datacasting, but subject to that constraint we said that it should be defined very liberally.

I know that there are discussions going on possibly at this moment elsewhere on this question, but would you like to go a little bit further in guiding us in this matter? One idea that I have floated in a talk afterwards was in terms of a limited amount of spectrum on any multiplex, and what we were trying to get of course in our report was something which would be not a source of litigation in this extremely litigious industry. So in saying it should be as liberal as possible we were trying to think of something that would not be litigious. How do you react then to, on a multiplex, a limitation on the amount of spectrum of so many megahertz being available and that limitation on spectrum simply being a definition of datacast, within that spectrum, be it one megahertz, one and a half megahertz or something like that, which would in itself under current technology not allow the full digital broadcasting, that in fact that would define a datacaster?

PROF HILMER: We were keen to get enough spectrum to make the pipe attractive commercially and I think a lot of us are speculating on how this is going to work but while you use the word in a liberal definition I think from our point of view we would say a liberal definition is one that allows a business to be developed, because at the end of the day we won't bid for spectrum if we don't see a business to be there. So we need sufficient scope in the definition to create business opportunities. Then we think about where will those business opportunities be for us, and they will, I think, rotate around our current areas of strength; news, current affairs and those areas of commerce, finance, employment, automobiles, homes, that are traditional strengths, where we have a lot of content, both editorial content and advertising content.

We need the ability to take those into a new format in a way that's going to be attractive to consumers. So we need an ability not just to, as I said I think last time, put lantern slides on the TV screen but to combine pictures, to combine text, to download enough data in enough speed in enough different formats that it's going to be an attractive and fast experience for consumers. I don't know if that completely answers the question but we've been concerned that we get enough spectrum to do that and if we have limited spectrum then we think that some of those commercial opportunities will be limited, but I'm not the technician to answer that in a defined technical way.

The other point I'd make is that I agree entirely with your comments with respect to process. Again, you would like to have a definition that's reasonably clear but you'd also like a process for resolving issues about the definition that was not encouraging of litigation and didn't allow game-play. We think that that is important and we would be delighted to see you progress some of the thinking on that. I don't think the answer though will be entirely in the definition. I don't think you'll ever get a definition that's absolutely clear and I understand the need for the definition in the current environment.

PROF SNAPE: Of course the definition on bandwidth is an absolute, as I understand it, an absolutely clear definition.

PROF HILMER: As long as it's not so constraining that you end up not doing things with the technology or with the channels that you think are really going to be important. As I say, our own advice is that - given the range of services that we'd like to offer and the way these services interrelate, for example, to switch from a motoring or real estate application into a finance application, in and out of, triggered by news or current affairs or editorial content - our own view has been to date that the seven megahertz bandwidth is what we would require, the way we're thinking about it now. We could do more limited things and I guess that says it has more limited value and we have more limited interest in it.

PROF SNAPE: In Sydney, for example, under current proposals there may be only one seven megahertz band available, which, if you require seven megahertz, that means there would be one datacaster.

PROF HILMER: I think these are the very issues that cabinet has to think about as they think about varying standards and as they think about the way in which they carve up the spectrum and as the ABA presumably looks at the efficient use of the spectrum because there are varying scenarios where hopefully more than one is available.

MR SIMSON: Prof Hilmer, I'm curious as to why Fairfax would want to voluntarily limit the amount of video that you would be prepared or that you could make available in a datacasting environment. As was noted earlier, we've actually come at it from a different perspective, what we call a liberal definition of datacasting because we see that arbitrary limits of, for example, video of five, 10, whatever minutes are themselves arbitrary limits and they might be all right today, they may not be all right today, they certainly may not be all right tomorrow. So I'm just curious as to why you're coming at it from that perspective rather than proposing much more flexibility in what you can do under the banner of datacasting.

PROF HILMER: I think we're aware of the policy framework that we have to work within, which is government commitment to have a distinction between datacasting and broadcasting, not to have new licences, and then you have to make that definition work. I think the area of greatest tension in making that work has been around things like drama, comedy, live sport, and what we've been seeking is a way to put something up that we believe will allow us to do what we at this stage see is commercially attractive and make it very clear we are not seeking through any back door to go under a datacasting guise and become a broadcaster.

So we are thinking to come up with something that is feasible and would be a start in the period during which that datacasting, broadcasting definition is going to be really important. So it was really that thinking and it came from our frontline people who are really interested in and who are working on the kinds or programming that we do and they felt that it made a very clear statement that we're not seeking to become a backdoor broadcaster, we're seeking to do something that's quite different. None of these are perfect definitions. I think we agree with you on that. To some degree it's a question of just defining terrain and defining an approach and saying you're going to do these kinds of things.

I think of the datacasting as I've seen it and seen our own mock-ups of what we do as much more like the Internet with automatic transmission and properly sprung seats and a responsive engine. As we see the way in which that's used, the types of restrictions on fresh video content - not archival, by the way, so it will be a lot of video - on the archive, but making the point we're not broadcasting, we're not seeking for you to have this thing turned on and watch the Fairfax quiz or the Fairfax show or the Fairfax sport. We're providing something that is a different kind of service and it will appeal to users who have different kinds of needs than to be solely entertained. There's no easy answer to it. As I say, it's come out of a bottoms-up look at what would be practical and what would make a relatively clean statement that we're not seeking to broadcast as broadcasters understand and are really protective of their terrain.

MR SIMSON: Has been your main concern there not the cross-media ownership one? I mean, if the cross-media ownership rule didn't apply, was not there for example, would you have fewer inhibitions about going for the doctor on datacasting in terms of becoming a broadcaster? I'm just wondering from a Fairfax perspective, why not?

PROF HILMER: It's not just cross-media, it's also the availability of spectrum. I mean, it may not be a good business decision for us to acquire a free-to-air and use the spectrum for datacasting. That may not be the highest value use, but if there were more spectrum available then we would be interested in participating in that more spectrum and going down the datacasting route, as we've signalled. So I think the issue for whether Fairfax would be interested in a world without cross-media of owning TV is a different question and we may well be and I've said that is something we would look at, but the services that are being provided is not in place of datacasting or as a way into datacasting, I think it's a genuinely different business, providing movies and entertainment and live sport and sitcom. I think it's just a different business than the business of the kind of interactive TV emerging through datacasting.

MR SIMSON: The sort of interactive TV that you're talking about or you're proposing or thinking about using in the datacasting environment, using the digital spectrum, how do you see that in a strategic sense or even a market sense alongside or by comparison to other interactive delivery mechanisms, say for example, interactive services being delivered by satellite, such as Austar is proposing to do, some of the things that Telstra is proposing to do and Optus and Excited Home and others are doing? How do you see that suite of datacasting services that you wish to offer using a digital spectrum as different to those services that others are going to offer using different delivery mechanisms?

PROF HILMER: One of the things that makes media so much fun is its diversity of opportunity. I mean, even within print you get tremendous diversity of a magazine format, an insert format, a newspaper format, a leaflet format, and I think you're going to see content go out into many more different digital formats and there won't be exactly - I mean, they will complement each other, much in the way different print does. So if you're driving around and looking for a restaurant you may want to go into our CitySearch database via your mobile phone through WAP. That's one way in which you might use that database.

If you're sitting around at home and you're thinking about a restaurant and you're not constrained by being in your car and want the one within a kilometre of the tower that you happen to be picked up by on the mobile network then you might take a broader choice and you might mine the data differently and have different kinds of discussions and get into a bit more depth and say, "Well, I don't just want the closest one, I want a particular kind of look and feel," and it's much more a sit around and discuss process. It's just like you might want to grab a news headline, "We win Davis Cup", but then you might want to sit back and really read about the game and how close it was and what were the great shots and you might see some of those great shots and you might even like to see a replay.

We think a lot of these services are going to be complementary, you can take the format and it will be used in different ways. I think people will still use the Internet. When I'm sitting in front of my screen, half a metre from me, I'm going to do things on the Internet, I'm going to take a density of text on the Internet that I just don't think I will use when I'm sitting across a lounge room and we're using the sort of datacasting headline, high visual impact type slide format that will be used in datacasting. So I think these things are - that's one of the reasons we're attracted. What we're saying is that we've got a core of content in our company, we have terrific content. What we have to do commercially and I think what makes the market is be able to take that content onto different platforms and allow consumers to get access to it and to compete with it.

What we want to see is those barriers to us competing that way come down and others will come at us just as others say, "You've got this classified.com, we want to have a go at that through the net." Fine, we're happy to live in that world. Others will say, "We'd like to do specialised news services on the net." We say that's fine. The other point that Mr Raneberg draws my attention to is that as we get into more of these things we will have lower infrastructure costs, we'll get some economies of scope. We're interested in that as well.

PROF SNAPE: Sorry to go back to the seven megahertz, I'm sort of at the edge of my understanding here, but I'm referring to the submission that we have from NTL, they are appearing after lunch today. They say that within the seven megahertz, with current technology, there would be scope for four standard-definition television signals going out. Now, that's just under two megahertz each.

PROF HILMER: Yes.

PROF SNAPE: Now, now that's just under two megahertz each.

PROF HILMER: Yes.

PROF SNAPE: You said before that you'd require the full seven megahertz, well, that's meaning that you're going to be doing something that's more demanding than a standard definition television set - substantially more demanding than a standard definition television set.

PROF HILMER: Yes, all that we would want to have - yes, a significant amount of content coming down on different channels, whether it was a news channel or a shopping channel or - - -

PROF SNAPE: You'd want to have more than one channel?

PROF HILMER: Well, we would want to have a suite of related channels that consumers could switch between.

PROF SNAPE: I see, okay.

PROF HILMER: We wouldn't want to just broadcast news because when you look at our content base and when you look at the way this is going to work, we want to say, well, people are going to be in the news environment or in the shopping environment - weather is an important service. I don't know what others like the ABC will do.

PROF SNAPE: No, I understand now. I hadn't understood that you were wanting to put these several signals out at the same time. I thought they were going to be at different times.

PROF HILMER: I'm happy to come back to you when I check with our people, but that is my understanding.

PROF SNAPE: So it's a multichannel datacaster?

PROF HILMER: Well, it's datacasting a range of services that are interrelated and interconnected and that really give the consumer then the suite of content that we have in the most user friendly form.

PROF SNAPE: Again, I suppose what one could do on a multiplex is in fact if any one datacasting channel was being limited to say, one and a half megahertz, one in fact could get more than one so that you'd be able to do several of those things but on any one of those channels you would be limited and again, that would provide, as I would see it, a nice restriction on what you could do on any one of those signals by limiting the amount of spectrum that was available for any one of those single spectrums and it would be very simple to monitor.

I mean, you've got that amount of spectrum, that's it. It would be not a matter that would encourage litigation. It would seem to me a very simple way of getting around the sort of problem that you described of maintaining a distinction between datacasting and broadcasting and so far I've been puzzled why potential datacasters have not embraced this idea.

PROF HILMER: Let me come back to you on it. I'm happy to talk about it further without people and I'll come back with a note or if you'd like to talk further I'd be happy to do that.

MR SIMSON: Can I just clarify the Fairfax position with regard simulcasting standard definition and high definition. That's what's mentioned in - in that situation do you advocate high definition being mandated, albeit at whatever proportion of programming that that would be or do you see, as we advocated in our draft report, high definition being an option in addition to standard?

PROF HILMER: We could live with either. I think that's what we're seeking, that we could live with either. One of the issues is what does high mean?

MR SIMSON: Or how much?

PROF HILMER: Yes, well, how many - what density of signal and what standard is high. There is some scope in that but we think that on that issue we would like to see what we would call a moderate high and that it would be then - if it were mandated to be simulcast for a period, as I say, we could live with that. This is all part of a transition but what we don't want to see is people locked in. We don't particularly want to see the government making the technology choice - making the call with video recording it's going to be a beta world when the rest of the world goes to VHS. I think that would be the worst outcome to get.

PROF SNAPE: The access regime to stay for the moment with these big questions before we go to the calculations, if we have a number of platforms available, there's the Internet, various types of broadcasting, various ways in which broadcasting can be undertaken, you've got subscription, subscription coming through channel but also in other ways as well. So you've got a whole range - then you've got datacasting as well, if you've got a whole range of roads, pipes as you call them, doesn't the access question for any one of them then become rather redundant? If you have a multiplicity of ways of delivering your message, why do you then need access on one of those roads when there are half a dozen roads that take you to the same place?

PROF HILMER: I think, Prof Snape, we did address that in part in our first submission which was raising the issue of ownership of the roads. If all of the roads were owned by the same two or three or one person or one person had a dominant ownership position in the roads, then you might have a concern because it might look like there were three roads but there was only one tollgate into those roads. The second issue, and you'd have to see how this evolved, was the interchangeability, the substitutability of those roads. If it turns out one of the roads is really the winner, that is the road that gets you into most of the households at relatively low cost and that road were really blocked off, it's sort of cold comfort to say, well, you can get into 5 per cent of Australia at high cost. So you would have to look at the reality of competition. So it's the ownership and the substitutability and take up of the roads that is critical. We think again there's a bit of wait and see needed here but there should be a willingness to use these because this whole area is evolving quickly.

MR SIMSON: Again, before we get into the detail of the Kearney report, but just generally how do you propose to fund or how do you believe the conversion process should be funded from analog to standard/high definition quickly so that the opportunity cost is minimised that you've calculated in this report. It seems to be just left hanging. Who is going to pay the piper on this given that the political, as we've discussed many times - the politics of this is that while there's some - one marginal electorate out there with half a dozen key electors who still want their analog and haven't bought a 50 or 100 dollar set top box, that you've got a problem.

PROF HILMER: We didn't ask Kearney to address that and we didn't seek to address it because I think it's a policy issue. But the first question is is there benefit greater than cost, so have you got the funds to play with? Now, in the worst case - I mean, you could say, well how would the Kearney study lead you to fund it? Well, you'd buy everybody a box and if you've got two homes you get two boxes.

MR SIMSON: Who'd buy the boxes though?

PROF HILMER: The government would buy the box and the government would be half a billion dollars ahead because it's got the benefit of early release of all the spectrum, so it's got something to auction that it didn't have.

MR SIMSON: It's ahead in a GDP sense, isn't it?

PROF HILMER: Well, it's ahead in its own revenue sense because this is the incremental value of the early release, so it's ahead in an economic sense.

PROF SNAPE: So essentially what you've calculated here is a net profit?

PROF HILMER: A net profit. Now, that's an absolute worse case because if you or I were doing this as a policy exercise, we would say there's a vast majority of the population who don't require and ought not have subsidy and would have changed over anyway. So of the whatever it is, 3.7 billion, some portion of that you wouldn't find and then you might say, well, you can either do it on a means-tested basis or on whatever varying basis you want to do to say for those people who can't afford the box and who are about to move into a dark screen era, "Here comes your box."

But that was the whole idea, that there's enough in this to actually take an aggressive stance in getting a box into every set and that was a smart thing to do in terms of the national accounts. There was more economic gain than cost and that's ignoring all of the additional costs that - sorry, the additional benefits of the commerce by-products of having this happen.

PROF SNAPE: Perhaps if we go to the details, and as I understand the calculation and follow it through, it's essentially seeing what the profit would be. You've calculated the additional revenue that you see or at least the revenue which would be attributable to this and then you've made an assessment of the cost and so you're saying it would be profitable for someone to do this or some enterprise to do this - enterprises - and in fact it would be profitable for that enterprise to pay the $100 or $50 per household to install the boxes and to pay for the boxes. What you've done is essentially show it would be privately profitable.

Alternatively, just to follow the discussion just a moment ago if the government in selling the spectrum could in fact get to itself all this additional profit or this revenue, then the government could do it itself, but it would be a clever government that was able to get for itself all this additional profit. But if we then go from that profit, whether it be profit for the government or profit for the enterprises, it seems to me that if one is making the calculation that way for it and trying to look at it from society's point of view just on that profit, then one in fact should take account of the reduced profits elsewhere, if that is the way in which one is going about it. But in fact the calculation doesn't take account of the produced profits elsewhere.

You did mention that some of the advertising revenue was diverted, that it wasn't all new advertising revenue, that it was a diversion and so if one is adopting the methodology that you have here of additional revenue minus additional cost, but trying to look at it from society's point of view and saying, "This is the gain to society from having it," then one should have taken account of the reduced revenue and the reduced profit elsewhere.

PROF HILMER: We didn't go into the second order on any of the calculations. So, for example, the services providing advertising support to the broadcasters we didn't look at what they might make either so none of the second order effects were taken into account. Now, I'm not sure what the advertising mixed shift was exactly in the United States, we only know that there was a partial shift in advertising mix, but we know that the advertising market over that period for broadcasters grew an extraordinary amount, $40 billion.

PROF SNAPE: Yes, I'd like to come back to that in a moment. I mean, an alternative methodology - and this might get slightly technical, but not much - would in fact be to try and estimate the additional consumer benefit from it all rather than an additional profit - the additional consumer benefit, in which case one would be in fact trying to estimate the additional consumer surplus which was attributable to the introduction of these new services. Now, that's the normal way, I think, of making a calculation of the gains to society from a new product. You've already got gas, let us suppose and you've got gas available at a particular price to consumers. You're now going to introduce electricity and what you calculate is the additional - at a certain price you calculate the consumer's surplus, the consumer's benefit that's attributable to that and you don't just focus on was it profitable. If you're looking at that sort of major change you're going to try and say what is the net addition, particularly when a policy is involved to allow this new product, what is the additional consumer surplus etcetera.

Now, that is another methodology and perhaps a more conventional economic methodology for going about calculating this cost that is gained from this new service - no, but you haven't done it.

PROF HILMER: But what we did do, we used as a reference - we work independently but with NECG with Prof Henry Ergas and had him kick the tyres, as it were, on our own calculations and compare them to some calculations of his own. Now, you see on the letter, that's part of the appendix, to the report that he used methodology focusing solely on social costs and benefits as you described and came up with a similar number.

MR SIMSON: Just for comparative purposes, one of the, if not the major argument that has been put to this inquiry from the incumbents, if I could call them that, against more competition is the fragmentation that would occur, they say, in the advertising market specifically in revenues. In other words, that the cake could not sustain more players. This is a critical assumption on which there has frankly been a dearth of analysis. It's basically looking at an historical trend and saying, "This may or may not continue and therefore if another one comes in it's divided and we've lost 20 or 25 per cent of our revenues or whatever."

What you're doing here, it seems to me, is challenging that are you not? You've approached it for somewhat of a different reason in the way you've done the analysis but overall what you're saying is that the impact of the digital era, if I could put it very generally, will result in substantially increased revenues from a number of sources advertising online and subscriptions that mean, if I'm reading this correctly, there will be a substantial increase in the total revenue pie that is available to medial players in this particular space. Is that a fair summary?

MR RANEBERG: That is correct.

PROF SNAPE: Looking then at exhibit 10 that you referred to before, where you have got that US television advertising revenue growing between 1980 and 1999 at compound 8 per cent, I think, and at the bottom you note that there has been an increase in the number of channels from 26 to 69, do you know of any study which has tried to unpack that and to in fact find what - or try to discover, put it just in that form, try to discover what increase in that revenue could be attributable to the increase in the channels per se rather than to other factors?

MR RANEBERG: No, I don't, and I don't know whether all the value accrued to a small group or whether it was evenly spread. I only know this to be the overall trend. What do know though in Australia is that, looking to the graph on the right, that same page, that the experience in Australia is not dissimilar to the experience of free-to-air networks in the US. They have had very strong growth in advertising.

PROF SNAPE: We know it has gone up but the question is, when one confronts the argument, that at any point of time there is a "fixed pie", what would the increase in the number of channels do to that?

PROF HILMER: Could I comment on that, because I think it's just a flawed analogy, "fixed pie". I mean, what you have in a business is if you look at what the material costs in a business of 20, 30 per cent, then the rest of the cost of a business has to do with design and consummation of a sale, inducement that goes into getting that sale to occur, the accounting for the sale, and the ongoing relationship and servicing of the customers. Now, we draw a line in that expenditure and we say, "There's a pie and it's advertising and it's putting a picture on a screen or putting an advertisement into a newspaper, and that's the lion's share of what we define as the pie." But what this technology does is it changes where the boundaries of the pie are very dramatically. We see that already in our Internet businesses and I think that's why you see - I am not saying for a minute they're right, but it's why you see the kind of valuations you do of the whole Internet world.

What we're really doing is changing the way in which value is added above the production, and sometimes even in the production cycle through the just in time type opportunities that this technology makes available. So to say there's a pie and the pie gets broken up just misses the whole point because what we're dealing with is a fairly radical change to the whole process by which you create, make and sell products. To just pick one part of the sell part, the ad part, and say, "That's it, that's the game," misses the whole point, which is why you have got to have competition because that's how incumbents always look at industries.

PROF SNAPE: Be that as it may, we have been getting many, many - - -

PROF HILMER: I am trying to give you a helpful comment on why that's so flawed.

PROF SNAPE: Thank you.

MR SIMSON: So your view would be that the reasons that you have mentioned and the analysis that's contained in this paper, that there is scope for more players in the provision of broadcasting services profitably.

MR RANEBERG: That's right, and we point to the pay TV networks. A lot of them are turning a profit at the moment but if we believe what we read about Austar they will be by the end of the year. It depends of course how you record that but as I said before, if we look at the market capitalisation, if we look at the value of the broadcasting services in Australia, 60 new channels have been introduced, and it hasn't affected them. If you look at the growth in the value of the broadcasters it has just continued to increase and there's no blip on their growth.

MR SIMSON: In your professional judgment if there were to be introduced, for example, a fourth commercial free to air, what would you see as the ramifications?

MR RANEBERG: As I said before, we can only go by reference points. I'm using reference points of the UK with the fifth channel, using the experience in the US. We believe that there is scope for more services. Studies in Australia have been inconclusive in Canberra and in Perth when new channels have been introduced but experience now in the market suggests also that perhaps with these new services being more sophisticated because the services that they're offering aren't that similar to what has been available in the past. It's not - - -

MR SIMSON: This is a big problem, isn't it, because potentially the assumption as to the pie as underpinned or is underpinning much of the policy development, the policy that is emerging as it relates to the digital environment, right down to the discussion we were having earlier about what should be datacasting and how it can't be a broadcaster and so on and so forth.

MR RANEBERG: There's another element which we probably should tip into the discussion which is a recent paper put out by the National Office for Information Economy which predicts a net impact on national output of 2.7 per cent from economist activity, so it's another thing which we haven't included in our calculations has been the spin-off and multiplier effects of this type of activity in our local marketplace, not only in broadcasting, but of course in the other types of services, transaction, commercial services, that they could deploy through this network.

MR SIMSON: You also refer in your paper at paragraph 97 to the lower costs, operating costs, for the free to air broadcasters from avoiding simulcast of analogue, but of course that's not the way they see it, is it? I mean, they focus very much on the costs associated with the introduction of digital broadcasting rather than the savings from the ending of the simulcast.

MR RANEBERG: I guess all I can say to that is correct, but are you asking me if I'm surprised at that, because I'm not.

PROF SNAPE: Just referring back to paragraph 83 which was the paragraph that you offered to elucidate before, 83.

MR RANEBERG: What page would that be on?

MR SIMSON: Page 18.

MR RANEBERG: Which particular paragraph?

PROF SNAPE: I'm sorry - - -

MR RANEBERG: Sorry, we haven't numbered them.

PROF SNAPE: Okay. It's the paragraph:

> Assuming that the spectrum allocated for analogue television could be released by the provision of new services 10 years early.

On our pages it's following exhibit 10. It's the second paragraph after exhibit 10.

MR RANEBERG: Right.

PROF SNAPE: That's in fact the paragraph that you stopped at yourself and said, "Would you like an elucidation?"

MR RANEBERG: Sure. I can take you through that calculation if you would like.

PROF SNAPE: Just briefly.

MR RANEBERG: Sure. We have assumed the same growth rate of 8 per cent per annum. We have assumed that the bulk of the growth would happen in the first few years.

PROF SNAPE: The 8 per cent comes from?

MR RANEBERG: From the experience of the United States.

PROF SNAPE: Okay. So you have simply taken the compound from the US of 8 per cent for over the 20-year period?

MR RANEBERG: That's right.

PROF SNAPE: And said that's what will happen, okay?

MR RANEBERG: That's right.

PROF SNAPE: Okay.

MR RANEBERG: We have used an estimation of cash flow based on EBITDA from the ABA broadcasting financial results which they publish. It's approximately 20 per cent for EBIT and a fixed amount for depreciation not on cash items, so we have taken the broadcaster's level of cash flow generation. It's not profitability in a strict sense but actually cash flow. We have used a 9 per cent discount rate.

PROF SNAPE: Yes.

MR SIMSON: Could I just go back to your comments earlier, Prof Hilmer, with regard to what we had to say about the Trade Practices Act and what we saw as the need in the draft report for a special test. You indicated that you would prefer to - I think you used the term "feel the way", or feel your way or - - -

PROF HILMER: Wait and see.

MR SIMSON: Wait and see. You may have intimated that in fact that's what we recommended, but we did not recommend that. Could you explain how the economic test and the market tests of the Trade Practices Act deal with the sort of issues that we raised in our draft report to do with the media, to do with issues relating to cross business interests of media proprietors, the reporting of those, to do with issues relating to pressure that may be put on journalists or editors to do things, to write and report things in particular ways because it seems that you have not shifted your view that you expressed at the original hearing to us that at the end of the day you believe that the consumer will make a choice.

I think the way you put it, if I can summarise it, when you appeared before us last, that if a paper - I think it was in the context of the metaphor or the analogy of the casino analogy, that if a paper is reporting something in a biased way, that people will stop buying the papers, and clearly we see things as being a little bit more complex or complicated in that, but could you perhaps revisit that issue because it's one in which clearly we don't agree.

PROF HILMER: I think there are two separate questions. The first is the question of market test, what is a market, so when you look at an acquisition and you ask, "Does it substantially lessen competition in a market," you have to ask yourself, "What is the market?" The current interpretation of the Trade Practices Act, as the commission sees it, I think is accurately stated in your report. I have no issue with that but at the moment there's a tendency to see markets relatively narrowly in terms of media. On the other hand, the definition of markets in Trade Practices environments is not exactly static. These are like changing the constitution. I mean, they're circumstantial judgments based on a lot of economic analysis, and the commission hasn't really had to deal with any of these things in Australia in any significant way because they have been taken out of their hands because of cross-media and the general type regulation of the media and an unwillingness to allow competition law to do its thing.

I think last time I said to you, and we still see that in our own business, that we are certainly seeing, as we either decide what prices we believe are appropriate, that is, what prices we can set, or how hard we promote or where we see we have opportunity. When we look at markets we're increasingly looking at all of the media markets. We aren't just saying, "Well, we can price our newspaper advertising in absolute isolation." We think that there will be a merging understanding among both, you know, regulators, and I think there already is among buyers, that these markets are in fact quite tightly linked, and there may be more sensible ways to aggregate the markets around sectors such as financial services where people can say, "Will I go on a magazine, will I go on TV, will I go on the web site, will I go direct mail?"

In fact we're seeing increasing substitutability between even what is below the line and above the line which was always considered to be very separate areas. So I think we're saying, given that what we're doing is walking down a road of gradual change, don't rush in and again pre-empt normal competition analysis in this area. Let's take a "wait and see" approach and let the commission actually have to get its mind around a real case rather than try to guess how it might move into these areas, particularly with all the changes going on. The second issue that you raise is these issues of cross-business interest and pressure on journalists. I haven't really changed my view on that because I haven't heard anything that would cause me to do so. I mean, as I think I said to you last time, we don't live in a perfect world and you can't legislate perfection, and I do think that at the end of the day if there are aspects of the world you don't like, you ask, "What are the forces that are going to cause those aspects of the world to change?"

You can either say, "Well, that can be done by a regulator somewhere or it will be done by consumers exercising reasonably informed choices." So I think the dialogue we had last time about the casino or whatever - you know, maybe the first time you get away with it and the second time you don't, and people start to say, "This isn't right," and the third time you start to lose credibility. I don't know how quickly those things occur but I do think they occur more quickly than we often give the consumer credit for in terms of things like pressure on journalists. I mean, the world that we're arguing for which is a world characterised by more competition where change is done in a way that new entrants are allowed to emerge, is an area where those who put the pressure on journalists won't have the best journalists, and if you don't have the best journalists you won't have the best media outlet. If you don't have the best media outlet you won't have the best business. So I think they are to me the healthy mechanisms whereby these things are adjusted in real time but, you know, there's no perfection. In every area, whether it's a regulatory area or a market-based area, there is always going to be anomalies and imperfections.

MR SIMSON: Maybe. I mean, in a fully converged environment, to use that phrase, it may be that the competitive forces that you have just described or so described, would make it very difficult for some of the bad things that could occur to occur, which would put pressure on journalists and so on and so forth, and so that in the context of a transition to a fully converged environment, certainly we were raising the question as to whether you basically just punt it. I mean, that in the absence of a fully converged environment, that it's worth the risk to diversity and related issues that, as you pointed out, regulations such as cross-media have tried to mitigate against, as to whether you punt it, or whether in fact there is a role for a test along the lines that we were proposing, albeit not fleshed out, that we were hoping that Fairfax amongst others might have provided some assistance on, given your particular place in the media, so that as you put it you can wait and see. We can wait and see that the fully converged environment does produce all those checks and balances that would mean that the sort of naughtiness that we're concerned about, and others are concerned about, and upon which we received a lot of evidence, would not occur.

PROF HILMER: I think if I come back to your report, you said there were a number of conditions you would like to see met before you would recommend the full abolition of cross-media. One is number of television station limitations repealed. Well, it will be interesting to see how that plays out. Secondly, more spectrum made available for new broadcasters including datacasters. Well, again, you could watch that occur and see whether those concerns that were raised by others who appeared before you, and at this stage all of these concerns are speculation.

MR SIMSON: Hypothetical.

PROF HILMER: Yes, whether those concerns were actually being borne out in that environment. You had foreign investment limits repealed and you could see what that would do, so it seemed to us that as this market is being created, presumably one of your recommendations would be that somebody observe it and look for these things. If these things that you were worried about occur then you might say, "Before we go to final stage 4 we'll put in a public interest test in reverse into section 50," which is, you can deny a merger if you think it's against the public interest.

MR SIMSON: You just switch the onus in other words. Is that essentially what it is?

PROF HILMER: At the moment the commission has no right to prohibit a merger on the ground of public interest, so you would presumably give it the right.

MR SIMSON: That's right.

PROF HILMER: To approve a merger that's substantially less in competition, if it's in favour of the public interest it has that right, you would give it the right to prohibit a merger that did not substantially lessen competition if it was against the public interest, but that really does worry me. That to me is a last resort because public interest is quite difficult to define and it tends to be a lot of - it's not that it tends to be non-economic, it often tends to be bad economics and very costly to communities.

MR SIMSON: So what you're saying is let those three things happen, foreign investment, more competition, digital services, and as we said, at the end of that then see before you, or at the time that you're looking at the cross-media - - -

PROF HILMER: At the time you're about to push that last button you might revisit this issue and see whether you're satisfied how it has worked and who the players are today and how they've begun to stake out and exert their positions.

PROF SNAPE: Yes, whereas we in fact have got there, have put the fourth one in, and then review it to see whether it can be taken off, is our - - -

PROF HILMER: My concern is you put the fourth one in, you won't see a lot of thinking about market, because everyone will play the public interest game. We won't get competition regulation. We'll get public interest regulation done by a body that really isn't expert in it. So I would say focus that body on developing its competition expertise and only bring in public interest if and when you're convinced that'll fail.

PROF SNAPE: The risk then of course - I mean, it's making that assessment. It's then throwing it open. The problem then is unscrambling the egg if it in fact has broken badly.

PROF HILMER: You haven't unscrambled it till you press the last button.

PROF SNAPE: Yes.

PROF HILMER: You haven't scrambled it, sorry. You haven't - - -

PROF SNAPE: Yes, but that's - let's get onto the analogy since I introduced it. The point was that we're saying that if you're making a judgment you're looking at that market, you think it's okay and so you then make the last step. If you find out you're wrong, that in fact it has all been gobbled up by two or three major players, then you've got a Microsoft type problem or a TNT type problem and then you have to try and go - which I don't think has ever been done in Australia and I don't think at the moment there is provision for doing it under the Trade Practices Act, in fact, to break up, to insist on diversitude. Whereas we are saying, "Okay, be a bit more cautious," and have that public interest test in until you've then decided that it's not necessary.

PROF HILMER: Yes, and my counter argument to that, chairman, is that the move to two players can't really occur till you remove cross-media and so you're not going to push that button until you see what the landscape looks like with more spectrum and more players. So you have time. You don't have to make that call and, you know, our other sort of idea that we put on the table was: and if you relax the radio right of way you'd actually start developing the competition regulators' skills in market definition. So you'd have more confidence as to how this would work.

MR SIMSON: Could I just revisit the question I asked earlier, because you've put on the table an economic case for a fast conversion and you've put on the table some pricing associated with the set-top boxes etcetera. But you haven't put there the policy solution as to making it happen, so that we're not sitting around in 10 or 12 years and still having an interminable debate about why we're still simulcasting analog. I mean, if you guys were running the government what would you do? I mean, is the economic case so pervasive here that you would go out and subsidise the set-top boxes for Australians so that the conversion happened. What would you do?

PROF HILMER: I think if you gave Fairfax all the spectrum we would give an undertaking to the government to get a set-top box into every home one way or another.

MR SIMSON: What do you mean, "all the spectrum"?

PROF HILMER: All of the spectrum freed up by the analog. We'll take care of it for you.

MR SIMSON: And you'll bundle the newspapers at the same time.

PROF HILMER: Not a problem, it's not a problem. I think we have a lot of bankers lining up to finance us and I think it would be a great economic decision for everybody. But you see, to some degree, Stuart, it's not a fair question because we're not really in the policy-making role.

MR SIMSON: Well, that's debatable. But we are trying to get to the nub of this. I mean, this is fine in theory, okay? You've put on the table the economic case. But what should government do if it was to embrace your numbers here, in addition to the issue of simulcasting HDT and SDTV and those incentives to the consumer to make the switch? What should it do to clear that analog spectrum quickly so that the opportunity is not lost any longer than it needs to be?

PROF HILMER: Let me respond to it, because this whole debate was occurring in the absence of fact. I think you've started to bring some economic analysis and framework and we tried to bring some fact on social benefits and costs done, albeit from the profit or cash flow, using a cash flow methodology. I think these are really important policy decisions and those facts have to be on the table. That's what we were trying to do here. What it says to us is if you had to spend money to mop up the analog quickly you should, because the worst case of mopping it up quickly is paid for and we don't think it will be anything like that. So if you're saying, "What should we do?" well, if I were the government I would do it with incentives for a while and for some cut-off, which I can't define because I just haven't - neither of us and we didn't ask Kearney to do this.

We didn't look at the social data, save for some segments who say they clearly can't afford this. Where there are people on a pension or assistance we'll give them a box or we'll give them a voucher to get a box - and I'd mop it up quickly and leave nobody in the dark who couldn't afford a box under some reasonably liberal definitions of afford. That's what we would do, broadly.

PROF SNAPE: Thank you very much. Yes, well, that has been very helpful, as your initial submission was very helpful too, and this is - and for your oral elaboration of it too, which has been very stimulating. As we did before, I think we've had a very useful discussion of the issues and we thank you both very much for that and for the time that you've taken to do it all and effort. We will now adjourn for lunch. We are running a little late. Is NTL here? It's not here; that's good. So we hope they're not here for a little while. I think we probably need at least half an hour for lunch and we shall attempt to get back perhaps around about 10 to 2 or slightly after. So thank you very much.

(Luncheon adjournment)