Law & Economics Consulting Associates

Streaming, Competition and Contract Terms

In Screen Production in Australia

A Review of A Study Commissioned by Screen Producers Australia

By

Dr George Barker

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Contact Personnel: Dr George Barker (LECA)
Email: George.Barker@cleconsult.com

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Executive Summary[1]

In parallel with the increase in the use of streaming there appears to be increasing interest in the economic impact of streaming on media markets, and in particular on competition, as confirmed by a number of Government Inquiries and in academic literature. As this report outlines, the appropriate conclusion to draw on the economic impact of streaming is that streaming services have enhanced the competitive state of media markets, and reduced the need for regulation of market power in those markets. This view however continues to be challenged in a number of markets worldwide, based on a number of quite common fundamental mistakes in relevant economic analysis. This report seeks to expose these mistakes to minimise the risk of them being perpetuated further, and adversely affecting law and policy.

For this purpose, and to provide focus, this report provides an assessment of a 2021 discussion paper commissioned by Screen Producers Australia (SPA), and prepared by Lateral Economics (LE) entitled "Taking Australian stories and skills to the world in the age of global streaming" (LE Report). The LE report recommends that

> "Australia develop a UK-style terms of trade regime, to be overseen by the preeminent economic regulator, the Australian Competition and Consumer Commission (ACCC). To ensure that policy changes result in additional local production and are beneficial to the domestic industry, a terms-of-trade requirement should be supplemented by local content requirements for streaming companies." (LE Report Page 2).

Essentially LE is proposing a law that would require *collective bargaining* between

- Current licensed public service providers, government funded and controlled ABC and SBS, subscription television and streaming companies, and
- A coalition of producers represented by an industry peak body, presumably SPA

LE is very unclear about the objective of this proposed policy and the problem it is supposed to solve. My analysis reveals it is likely to harm competition and create significant harm to the welfare of Australians.

LE poses multiple goals or objectives for its proposal, raising questions about which of its objectives takes primacy, and how to make trade-offs between them. I instead focus on the Government's more fundamental, overarching, or higher-level objective, namely, the promotion of the wellbeing or welfare of Australians, contained in the Competition and Consumer Act 2010. I then assess LE's proposal against that objective using an economic cost-benefit framework. A key gap in LE's analysis is that LE explicitly acknowledges that its discussion paper is only concerned with the relationship between buyers and sellers of content, and fails to address the impact of its proposed UK-style regulation on consumer welfare. As we shall see, this is a serious omission, as consumers will be considerably worse off under LE's proposal, weighing heavily against LE's recommendation.

The basis, or reason LE claims there is a need for intervention, lies in an alleged key factual

[1] Acknowledgement: I am grateful to the Australian and New Zealand Screen Association (ANZSA) for financial support for this research. The views expressed in this paper however, and any errors, are mine alone.

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problem LE claims exists; namely "the profound imbalance in market power between buyers and production companies." Contrary to LE's claim, however, I show that there is no "imbalance in market power between buyers and production companies". First, I show that LE's analysis forming the basis of the above claim is flawed. LE failed to accurately define the market before calculating market shares and concentration and adopted a market definition that was too narrow, and which generated a high market concentration result. Given free-to-air (FTA), Internet-based protocol television (IPTV), and pay-TV services are no doubt part of the same market, market shares should be calculated for the combined market, not separately as LE does. When one does this and analyses FTA, IPTV and pay-TV services in one combined market, the level of the four firm market share or concentration is clearly very low, between 35% and 40% - much lower than the 70-80% cited by LE. Thus I show that if one assumes the FTA, IPTV and Pay-TV services "market segments" are the same size (as they were in 2017-18):

- The four main FTA broadcasters referred to by LE would on average have only 10% share each, and
- The four main IPTV and pay-TV players referred to by LE would on average have only 8.75% each, while
- Other firms combined would have 25% market share

This is not a very concentrated market on the buyers' side at all. It certainly does not reveal a "profound imbalance" as claimed by LE.

A second reason why there is clearly not a profound imbalance of market power is that barriers to entry to the market are clearly low, as shown by the recent entry of the streaming companies into the Australian market. The market is thus clearly highly contestable. Even if there were high market shares, or high concentration, low barriers to entry would limit any attempt to abuse market power. Such abuse will be disciplined by loss of market share to new entrants. LE does not identify or assess barriers to entry.

A third reason why there is unlikely to be abuse of any imbalance of market power is that it would require cartel or collusive behaviors. This would be hard to sustain in the current market, given the incentives for cartel participants to compete and cheat on any tacit or explicit cartel agreement to capture market share off other cartel participants. LE has provided no evidence of the existence of cartel or collusive behaviors.

Despite the absence of any reason to be concerned with a profound imbalance of market power I nevertheless review the contract terms described by LE as evidence of abuse of market power. LE alleges the following three types of abuse of market power or anticompetitive behaviours can be found in the terms agreed in contracts between producers as sellers and buyers of content;

1) Prices have fallen, so that Australian screen producers' incomes fall
2) Scope of the rights transferred to buyers by contract has widened to cover distribution worldwide and for sequels
3) Duration of the rights transferred to buyers by contract has increased, from 2 to 4 year contracts to 7 and 10 years, and even to in perpetuity.

However, LE fails to clearly establish that these contractual outcomes have actually occurred. More importantly it also fails to refute the alternative explanations for them: namely, that the new terms result from legitimate or efficient competitive market arrangements. On price falls for example, I conclude that even if they were to exist, they are most likely due to the more

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competitive market putting pressures on costs, or prices paid to producers, and this is good for consumers. On the other two alleged problems, contract scope widening and duration increases, again no evidence is presented that even support the claims made, but even if there were these are likely to be efficient as the large streaming companies are likely to need broad scope and long duration to justify the higher investment in the projects they fund, as well as in technology and in worldwide marketing and distribution. More efficient terms on scope and duration would also benefit consumers, and any regulation that threatens to alter such terms would be damaging to consumer interests.

I also show that LE fails to consider whether the current law adequately deals with any of the problems or risks with contract terms alleged by LE. I show that current law already clearly addresses the problems raised by LE. For example section 45 of the Competition and Consumer Act 2010 (CAA) is directly applicable, and it is administered by the Australian Competition and Consumer Commission (ACCC), the body LE recommends should administer the new law LE proposes. Thus any abuse of market power by content buyers leading to contract terms that substantially restrain competition, and are not in the interest of Australians, can already be reviewed by the ACCC and made unenforceable. Adding a new regulatory regime to the existing role of the ACCC in the same area, for the same reasons, even if it may have marginal benefits, would add additional or marginal costs, and risks, for little benefit. As I show for example, creating a special regime poses the risks of potentially exempting the film and TV production rights market from existing law, adding to the burden of both the ACCC and firms in the market, and complicating both the administration of and compliance with law.

My focus then turns to look at the marginal effect of the proposed UK law, compared to the current competitive market outcome and regulatory regime. I identify substantial costs and little to no benefits to the regime as proposed by LE. In essence I show the proposed *collective bargaining* under the law involves the unnecessary legalisation and facilitation of cartel co-ordination on both sides of the market. It will enable buyers and sellers on the two sides of the market to share information and co-ordinate (in effect form an "unholy alliance") and put up *both* of their prices, passing the price rises through to the end consumer, while reducing output and quality, further harming consumers. The regime will also add significantly to market transaction costs and regulatory costs, creating inefficiencies. As I show this will have significant adverse consequences for the welfare of Australians. My high-level cost-benefit, or regulatory impact analysis highlights that the proposed LE scheme is thus very likely to be highly costly to the welfare of Australians.

In short, the exact opposite to that predicted by LE will occur. LE's recommendations should not be followed. Instead, reliance should be placed on the highly competitive market that currently exists, with continued reliance on current law to deliver better outcomes for Australians.

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1. Introduction

Streaming media online is a relatively recent phenomenon. Streaming started slightly earlier in music compared to the screen, no doubt as music digital files were smaller and easier to stream than film and television files. The tipping point in commercial music streaming came in 2008 with the launch of Spotify.[2] By 2015 music streaming services were responsible for 19 per cent of the year's total global music industry revenue, reaching 65% in 2021. [3] Turning to the screen, the first popular video streaming site was You Tube, founded in 2005, with Netflix introducing streaming services in 2007. [4] By 2015 screen streaming services were responsible for around 23% of the combined total global theatrical and home/mobile screen entertainment revenue, reaching 72% in 2021.[5]

In parallel with this increase in the use of streaming there appears to be increasing interest in the wider economic impact of streaming on media markets, and in particular on competition. For example over recent years there has been an increasing number of Government inquiries or studies into the impact of streaming, both in film[6] and music.[7] There has also been a growth in academic interest.[8]

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[2] Given Spotify was slow to expand outside a few European countries, only arriving in the USA in 2011, other companies offered their own music streaming model. Giants like Apple, Google and Amazon and many smaller companies have now all launched streaming platforms, each differentiated in key ways.

[3] See IFPI Global Music Report https://globalmusicreport.ifpi.org - streaming services share of total revenue is higher in some jurisdictions, being more than 80% of total music sales now in the UK for example, according to BPI's 2021 yearbook "All About the Music 2021".

[4] Others soon followed and by 2019 competition between video streaming services included Netflix, Amazon Prime Video, Hulu, HBO, HBO Max, Disney +, Paramount+ Apple TV+ and Peacock. This competition increased during the first two years of the COVID-19 Pandemic as more people stayed home and watched TV.

[5] See MPAA THEME reports in 2017 https://www.motionpictures.org/wp-content/uploads/2018/04/MPAA-THEME-Report-2017_Final.pdf and 2021 https://www.motionpictures.org/wp-content/uploads/2022/03/MPA-2021-THEME-Report-FINAL.pdf

[6] See final 2018 report of the Australian House of Representatives Standing Committee on Communications and the Arts (AHRSCCA) inquiry into the Australian film and Television industry here: https://www.aph.gov.au/Parliamentary_Business/Committees/House/Communications/~/link.aspx?_id=EF51E047D498405887DED977FB6EC3DE&_z=z

[7] See the final 2019 report of the AHRSCCA inquiry into music streaming here: https://www.aph.gov.au/Parliamentary_Business/Committees/House/Communications/~/link.aspx?_id=C73AE9EB1ED84C32A92E5C50653DAD0F&_z=z In the UK, see the final 2021 report of the UK Parliament's Digital Culture Media and Sport Committee inquiry into the economic impact of streaming here https://committees.parliament.uk/work/646/economics-of-music-streaming which recommended a 'complete reset' of music streaming to fairly reward performers and creators. Also see the final 2022 report of the UK Competition and Markets Authority (CMA) full market study into music streaming and the dominance of the major music groups here: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1120610/Music_and_streaming_final_report.pdf). In Canada see the 2019, and 2021 Federal Department of Canadian Heritage commissioned and published studies of the economic impact of music streaming (including on competitive conditions) here: Wall Communications Inc. (2019). Study on the Economic Impacts of Music Streaming Platforms on Canadian Creators https://www.canada.ca/en/canadian-heritage/services/copyright-policy-publications/economic-impacts-music-streaming.html#a2 ; and Wall Communications Inc. (2021) Study of the economic impacts of music streaming on the Canadian music

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As noted a key focus of interest has been on the impact of streaming on competitive conditions in the relevant markets, and in particular on contract terms offered creators and producers, including their earnings. A just completed major Government study into music streaming in the UK by the Competition Markets Authority (CMA) for example focused on this topic, and concluded that streaming had increased competition and improved the contract terms for creators, and that any concern with the low earnings of artists through the pandemic and beyond would not be well addressed by competition law interventions into their market relationships.[9]

This conclusion that streaming services have enhanced the competitive state of media markets, and reduced the need for regulation of market power in those markets, continues to be challenged however in a number of markets worldwide, based on a number of quite common fundamental mistakes in relevant economic analysis. This report seeks to expose these mistakes to minimise the risk of them being perpetuated further, and adversely affect law and policy.

For this purpose this paper provides an assessment of a discussion paper commissioned by the Screen Producers Australia (SPA) and prepared by Lateral Economics (LE) entitled "Taking Australian stories and skills to the world in the age of global streaming" (LE Report) LE summarises its' brief, or the terms of reference for the LE report as follows:

> Lateral Economics has been engaged by Screen Producers Australia to study the contract terms which Australian production companies supply buyers of their content, including but not limited to free-to-air broadcasters, Foxtel, and streaming companies such as Netflix, Prime Video, and Stan (LE Report p8)

The LE report recommends that

> "Australia develop a UK-style terms of trade regime, to be overseen by the preeminent economic regulator, the Australian Competition and Consumer Commission (ACCC). To ensure that policy changes result in additional local production and are beneficial to the domestic industry, a terms-of-trade requirement should be supplemented by local content requirements for streaming companies." (LE Report Page 2).

There are thus two main elements Lateral Economics recommendations have

i) Competition Law – LE recommends regulated collective bargaining by cartels of buyers and sellers of their terms of trade.
ii) Content Law - LE recommends linking content quotas and tax incentive to the terms of trade regulation

LE claims that its recommendations are required on

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industry (June 2nd 2021) see https://www.canada.ca/en/canadian-heritage/corporate/transparency/open-government/economic-impact-music-streaming.html#shr-pg0

[8] See for example Olivia Pakula, (2021) The Streaming Wars+: An Analysis of Anticompetitive Business Practices in Streaming Business, 28 UCLA ENT. L. REV. 147.

[9] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1120610/Music_and_streaming_final_report.pdf

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> "the basis of the profound imbalance in market power between buyers and production companies" (page 2)

My focus is on the terms of trade recommendations. A proper regulatory impact analysis or cost-benefit analysis (including competition related effects) is required to justify LE's recommended UK–style regulated terms of trade. LE's recommendations have to be assessed relative to:

- The Australian Government's overarching objective in the regulation of markets through the ACCC;
- The change in context justifying the LE discussion paper and regulatory change;
- The costs and benefits of moving from current arrangements to the counterfactual arrangements proposed by LE. Thus the proposed UK regulatory style option, has to be compared to
  - Continued reliance on the current market, and
  - Supervision of current market arrangements under existing rules in the Competition and Consumer Act 2010 (CCA) and the underlying common law doctrine on price fixing, cartels and restraint of trade clauses in contracts

The LE report is broken into four sections:

> **Section 1** "Setting the Scene" constitutes around 12% of the main report. It discusses the market and how it has changed, claiming market concentration amongst sellers is very high, generating oligopsony market power.
>
> **Section 2.** "Contractual Terms and the Microeconomics of Screen Production" constitutes about 40% of the main report. Section 2b claims buyer market power and negotiating power are biasing contract terms in the favour of buyers. The two other sections 2a and 2c respectively describe and then analyse problems with six different kinds of contract terms.
>
> **Section 3** "Improving Contract Terms" constitutes about 18% of the main report and discusses how policy can affect contract terms and the nature of relevant policy in other countries mainly the UK, France and Canada.
>
> **Section 4 "**Crafting a Policy Package" constitutes about 9% of the main report and presents LE's policy recommendations.

The remainder of my report is broken into six sections:

1. Assessment of the Relevant Government Objective
2. Market Definition and Context - What has changed? And How?
3. The Alleged Market Power - Does it exist?
4. The Problems with Contract Terms identified by LE – Are there any?
5. Current Law for dealing with Market Power - Does it suffice?
6. The nature of LE's proposed UK style regulation and its likely economic consequences

My report concludes that LE's recommendations should not be followed. Instead, reliance should be placed on the highly competitive market that currently exists, with continued reliance on current law to deliver better outcomes for Australians.

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2. Government Objective

LE seems to focus on multiple objectives or goals including "promoting Australian stories in Australia and on the world stage" (page 2) and "securing future income streams," and "retaining as much future income from successful productions in Australia as possible". As we shall see the LE proposal would however clearly harm these objectives. LE's proposal that Australia focus on these multiple, narrow, and conflicting objectives for one policy is inconsistent with the existing law and approach to the area in Australia, and would inevitably compromise the effectiveness of policy.

LE's proposal needs to be assessed instead against the Australia Government's current single overarching objective for the competition law issues raised by LE – and not the secondary and narrower ones adopted by LE. The objective of competition law interventions given to the ACCC is found in Section 2 of the Competition and Consumer Act 2010 (CCA) which states the object of the law is

> "to enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection".

This highlights that the overarching concern of any competition or fair-trading intervention has to be judged according to whether it *promotes the welfare of Australians*. This is most relevant to LE's proposed terms of trade regulation.

LE fails to make a sound theoretical or empirical case that its recommended interventions will promote the welfare of Australians. Indeed our analysis that follows of the current market situation is that it is highly competitive and output and quality of films is improving which enhances the welfare of Australians. Our analysis of the likely impact of the LE recommendations is that it will make Australians worse off over time not better off. The reason is that it will cause deterioration in competition. Competition in Australian Screen production is most likely to promote the welfare of Australian. Indeed it is clear from ACMA's recent 2022 report on streaming services[10] that the increased competition from streaming has promoted the welfare of Australian consumers. It has brought more investment in Australian content, at a higher quality and a lower price point. Thus ACMA reports that in the 2021–22 financial year, five subscription video on demand (SVOD) providers – Amazon Prime Video, Disney, Netflix, Paramount+ and Stan – spent $335.1 million on 718 commissioned, co-commissioned or acquired 'Australian programs', with the total expenditure on Australian programs growing by $156.2 million, compared to the 2020–21 financial year. [11] This SVOD expenditure supported the production of Australian programs across a range of genres, with all providers contributing to commissioned or acquired Australian drama ($199.9 million) and Australian documentaries ($37.4 million). [12]

[10] https://www.acma.gov.au/spending-subscription-video-demand-providers-2021-22-financial-year
[11] ibid
[12] ibid

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3. Market Definition and Context: What Changed? What is the Problem?

Why have this review of contract terms, and the recommended law change? If the contract terms are determined in a competitive market context, they may change over time as an efficient response to changing market conditions. What necessitates a change of law as proposed by LE? What has changed in the market competitive context? Where is the evidence of market failure? Why has the market failed? Why isn't current law enough to deal with any change?

Given market reviews, and changes to law are costly, and the resources spent on them can be devoted to other pressing demands including reform priorities, a strong case must be made explaining what has changed that necessitates law reform. One would thus have expected to find a succinct explanation motivating the review in chapter 1 of the LE report entitled "Setting the Scene". At the outset of Chapter 1 LE summarises its claims about relevant market-related changes in three points:

1. "Australia's screen production industry has been disrupted by the internet, social media, and the entrance of streaming companies.
2. Models for commissioning new screen content have changed, and buyers are seeking more extensive rights over a longer period, including worldwide distribution and other rights, which previously would have remained with the production company or would have reverted to them after several years.
3. The industry that commissions and buys screen content (i.e. TV networks and streaming companies) is highly concentrated, comprising a few large firms, but the screen production sector from which it buys comprises many, much smaller competitors." (see Page 8)

The first two points clearly involve change. It isn't clear however what problem, if any arises from these changes justifying a market review and law reform. Apart from the lack of evidence to support its claims, LE does not evaluate whether this disruption has delivered positive benefits to producers, despite the abundant evidence that screen production investment is booming in Australia. As we shall see in this section, they may both be efficient changes. The first point results from technological innovation leading to advances such as the increased streaming of film and TV, and thus seems to have increased competition, and benefited Australian producers and consumers as a result. The latest Screen Australia Drama Report thus shows investment in Australian drama, children and documentary content of $1.5bn, nearly doubling the 2020/21 number (which itself was a record-year).[13] On the second point, more extensive contract rights for a buyer, over a longer period, may be reasonable or involve efficient and legitimate business practices, and producers may be compensated in greater volume purchased, more investment, or a better price paid in the future. Alternatively, the changes may simply involve a distributional change reflecting changes in relative scarcity, without efficiency or consumer welfare consequences. So why be concerned?

Only the third point raises a clear policy relevant concern, as LE is claiming here that there is an oligopsony market structure that gives rise to the risk of abuse of oligopsony market power. An oligopsony is a market in which the number of buyers is small, while the number of sellers in

[13] https://www.screenaustralia.gov.au/fact-finders/reports-and-key-issues/reports-and-discussion-papers/drama-report

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theory could be large.[14] If true, this may justify LE's concern with the changes observed in the terms of trade. As we shall see however, LE does not provide evidence of an oligopsony, let alone that oligopsony power might have increased or been abused, nor that existing law is insufficient to deal with any problem, so as to justify concern with the changes observed in the terms of trade - and consideration of a new UK-style law.

In this section we shall briefly focus on LE's last point about market structure, and in particular on whether there have been changes in market structure that may have increased the risk both of oligopsony power, and its abuse, and which may justify concern with the changes observed in the terms of trade, and the proposed review of current law; or. whether the changes are simply better viewed as efficient, legitimate business practices and a response to competitive market conditions. We shall start first by stepping back and briefly discussing market definition.

3.1. Market Definition and Context

A necessary and critical step in any analysis avoided by LE is market definition. This is needed in order to frame later analysis or identify whether the current market is competitive, or if there is market power, its nature, and source or location. The market definition step is also necessary to quantify the costs and benefits of changing current arrangements through the law proposed by LE. Market definition involves clarification of the functional dimension or stage of the value chain under consideration, the products or services involved, the geographic scope of the market and the time dimension, or relevant period of assessment.

Before proceeding then it is helpful to spend a little time on market definition. One can distinguish a number of markets in terms of function, or the vertical value chain from creation of a new idea for a film, through production to distribution to consumers, involving a series of intermediate markets leading to the final consumer market where the value of film, and the welfare Australians is realised as follows;

a) Market for Distribution to the Final Consumer - This is where consumers acquire access to films from distributors including
    i) Streaming Companies (e.g., Netflix, Stan, Disney+)
    ii) Licensed Public Service Broadcasters (PSB) including free-to-air (FTA) broadcasters (Seven) and subscription broadcasters (Foxtel)
    iii) Subsidised and licensed Public Service Broadcasters (PSB) like the Australian Broadcasting Corporation (ABC) and the Special Broadcasting Service (SBS).
b) The Market for Film and TV Production rights - This is where film distributors (streaming firms etc.) acquire the rights of film producers. There may be vertical integration in this step where a company makes and distributes its own film.
c) The Market for Creators rights. This is where film producers acquire the rights of creators and combine them with other inputs (like finance) required to produce films. This includes the many copyrights required including in scripts, music etc. created by the many creators involved, including:
    i) Writers
    ii) Composers
    iii) Costume designers

[14] A monopsony (or sole-buyer) by comparison arises where there is only one buyer with 100% market share.

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iv) Set designers
v) Actors
vi) Directors etc.

There may be a degree of vertical integration by some firms between the above markets

The table below shows how the three related markets above are layered on top of each other in a value chain from bottom to top. Sellers are shown in the left column and buyers in the right column, and the three markets at each level are shown in shaded rows with the market for creative rights at the bottom and the final consumer market at the top. Starting at the bottom row *in the market for creators rights* then one has creators and creative artists in the left hand bottom cell, who sell creators' rights to Film producers shown in the bottom right hand cell. In the third from bottom row we have *the market for film and TV production rights* with Film and TV producers now acting as sellers, selling their rights to key buyers and distributors, including the new global streaming companies and licensed and subsidised PSB shown on the right. At the top one has the final market for distribution with new global streaming companies and Licensed and subsidised PSB shown now shown as selling rights to consumers.

Table 3.1

Sellers	Buyers
a*) Market for Distribution of Rights to Final consumer*	
1) Streaming Companies 2) Licensed PSBs including FTA broadcasters (Seven) and subscription broadcasters (Foxtel) 3) Subsidised PSBs like ABC and SBS.	Final Consumers
b) Market for Film & TV Production Rights	
1) Film producers	1) Streaming Companies 2) Licensed PSBs including FTA broadcasters (Seven) and subscription broadcasters (Foxtel) 3) Subsidised PSBs like ABC and SBS.
c) Market for Creators Rights	
Creators/Creative Artists including a) Writers b) Composers c) Costume designers d) Set designers e) Actors f) Directors etc.	1) Film producers

LE focuses solely on

> "The contract terms negotiated between…buyers of content and their producers" p13

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This locates their interest in b) the market for film & TV production rights. Given this is once removed from a), and the final Australian consumer, LE do not clearly explain why and how, nor the extent to which the current arrangements in the market for film production rights may necessarily adversely affect the welfare of final consumers. LE indeed explicitly acknowledges that its discussion paper does not address the impact on consumer welfare of current contract terms between buyers of content and their producers, nor the impact on consumer welfare of its proposed UK style regulation ((Footnote 1 page 9). This is a critical, indeed fatal gap in LE's analysis from the perspective of the Government's objective. A further gap is the failure of LE to consider the consequences of intervention in the market for film production rights not only for consumers "downstream", but more generally for other related markets including "upstream" in the market for creator rights, including the market for music rights in film, as well as the market for distribution.

On the functional dimension, LE also fails to distinguish or mention the roles of other key input markets including:

- The market for broadcasting licenses [15] in which the Government controls entry to broadcasting markets;

- The market for Government subsidies to support public broadcasting, in which the Government buys or finances content; and

- The advertising market in which private third parties buy advertising time, or slots and finance advertising content to be shown either within or alongside film and TV content.

These markets involve and require different policy approaches. For example, as we shall see later, the terms of trade intervention in the UK was designed specifically to deal only with problems caused by subsidised and licensed public service broadcasting (PSB). However, LE makes the mistake of assuming that the UK law can be simply repurposed and made directly applicable to new media platforms in Australia, including streaming services, which are not controlled by Government licensing or supported by Government subsidies like ABC and SBS. As we shall see later LE should not have made this assumption, as it is not justified, highlighting the need for careful consideration of market definition. Indeed in the UK there is no suggestion that terms of trade should be extended to streaming companies – PACT (the UK trade association representing producers) is not advocating for it.

Besides the nature of the above related functional markets relevant to LE's analysis, and the impact of both current arrangements and LE's proposal on them, LE fails to adequately distinguish the different products and product markets involved along the product dimension of the market, and likely impacts on them. A key determinant of product definition are the terms of the contract under which a product is sold. One then has to look at *contracting in its entirety*. The

[15] A broadcast license is a type of spectrum license granting the licensee permission to use a portion of the radio frequency spectrum in a given geographical area for broadcasting purposes. The licenses generally include restrictions, which vary from band to band, as spectrum is typically divided according to use. Streaming firms using internet protocol and Pay TV firms using cable for example are not subject to this regulation

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reason why is that a service like that performed by a producer is defined by all the terms of the contract under which it is performed together. Thus a narrow focus on only one term in a contract such as duration or scope may lead one to ignore how changes for example on duration (that may adversely affect producers) are offset by a change in price, or in the volume of demand for services at any price, over time, that taken together may leave producers "whole", or more than compensated for any adverse change in the duration term. There may thus be no net economic effect between producers and commissioning firms of a change in one term, after one considers *contracting in its entirety*, due to compensating changes in other terms

Finally, one other relevant dimension of the market not adequately analysed by LE is the time dimension. This includes LE's failure to conduct an adequate historical or contextual analysis covering recent trends, the nature of changes in the markets of concern, for example in competition and contract terms (price, volume, duration, scope), and the factors that have driven change. This historic or contextual analysis should have then supported a more forward-looking analysis of the market for future film and TV productions relevant to an assessment of the merits of the proposed new law. LE for example fails to accurately describe the relevant context. In particular there are more buyers now as highlighted in the next section, so Australia now has a much more competitive set of film and TV markets in "the age of global streaming" as LE calls it. This has led to substantially greater investment in Australian production[16] and greater innovation. There has always been a lot of people with a lot of film ideas and ease of entry by new film producers, so film producers always face a lot of competition. The problem is that there are not a lot of great film ideas worthy of investment developed by a producer capable of executing it at the required quality level. Open and extensive competition between producers is therefore required to weed out the good ideas from the bad. A great idea can now be better and more readily funded as the promoter can in effect auction it off to a larger number of major global players. Thus as we shall see in the next section, LE fails to make the case that over time, things have changed so adversely for market participants (including consumers) that it justifies a costly inquiry into alternative policy settings of the kind LE proposes. In fact, quite the opposite is true.

It is relatively easy on a preliminary basis to illustrate the importance of distinguishing between the functional, product and time dimensions of the markets when considering LE's analysis of market competition and policy. For example, the critical effect on consumers (which LE ignores) of current arrangements, and LE's proposed policy is through:

- Its impact on investment in production upstream, and therefore on the quantity and quality and prices of films made, but also

- The extent to which any cost effects are passed through to consumers without offsetting benefits.

When analysing the first point, time is important, as at the outset or before any change, investment or quality or output or prices may be too high or too low in terms of their contribution to the total welfare of Australians. Changes up or down over time do not confirm current arrangements have led to an adverse effect on welfare of Australians necessitating intervention. Any change in terms of trade (including scope, duration, or price) may only be distributional in

[16] https://www.screenaustralia.gov.au/fact-finders/reports-and-key-issues/reports-and-discussion-papers/drama-report

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their effect as between producers and commissioning firms or relating to relative prices of inputs perhaps reflecting a change in their relative market scarcity values, with no consequences for total Australian consumer welfare. The extent to which any changes are passed through to consumers also depend on a number of economic laws, called the Marshall Hicks Laws, which govern the extent to which changes in an intermediate market may be passed through to the final consumer and affect consumer welfare that LE do not explore (such as the elasticity of final demand). Any change in one market may also be offset by changes elsewhere in other markets that are related. For example, the value-adds of streaming, including the greater choice and access to films for the Australian consumer, may more than offset any negative effects arising in an upstream market due to contract terms in the streaming market. This is not made clear by LE.

In general, LE do not conduct relevant market definition analysis to enable them to analyse or explore the multiple factors relevant to determining what is changing in which markets, and if any change in one market may affect the welfare of Australians in other markets in general equilibrium, and thus at the outset fail to make their case. The matters they discuss may just be the effect of legitimate competition or involve distributional concerns, not total welfare concerns or the size or quality of the total film and television pie.

3.2. LE's Evidence on Market Structure and Concentration

Given the above preliminary market definition, if one reviews the evidence presented and relied on by LE, a major problem with market competition does not seem to have arisen in the market for Australian film and TV production rights that warrants the development and implementation of a new policy or new Government intervention. If anything, it seems likely the market has become more competitive, refuting LE's hypothesis that matters may have deteriorated in the recent past and supporting the opposite policy conclusion and recommendations to those derived by LE.

LE presents the following data to justify its claim of market concentration, or oligopsony power, in the market for Australian film and TV production rights. First, on the buyer-side, LE claims:

> "The high degree of concentration on the **buyer-side** is illustrated by IBIS World's assessment that industry concentration
> - Among FTA broadcasters in Australia is high, with the four largest players (the three commercial networks and the ABC) accounting for nearly 80% of industry revenue.[17]
> - Among Pay Television and Internet Protocol Television Services (i.e. Foxtel and the streamers), the four largest players account for over 70% of revenue.[18] (LE Page 9)

Second, on the seller-side LE claims:

> "While there are some large players on the seller side, particularly those that are part of

[17] On this point LE Cites IBISWorld (2021), Free-to-Air Television Broadcasting in Australia Industry Report, p. 26.
[18] IBIS World (2021) Pay Television and Internet Protocol Television Services in Australia Specialised Industry Report, p. 26.

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> multinationals, most industry participants are SMEs, typically with no more than a handful of permanent staff. It is true that some relatively small production houses are owned by large multinationals.
>
> The low degree of concentration on the seller-side is illustrated by IBIS World's assessment that industry concentration in Motion Picture and Video Production in Australia is low. The four largest players account for less than 20% of revenue." [19]

The above data leads LE to conclude:

> The clear disparity in industry concentration measures between the buy-side (i.e. major players accounting for 70-80% of revenue) and the sell-side (i.e., major players accounting for less than 20%) of revenue suggests that TV networks and streamers could be considered an "oligopsony," which potentially can sway contractual terms in their favour relative to what would occur with a lower disparity in industry concentration measures. This means that production companies may be pressured by the buyers which have more market power to accept poorer contractual terms than they would in a more competitive market among buyers. (page 10)

LE's analysis of IBIS World data presented above is central to LE's claim there is a "profound imbalance in market power" and more importantly its recommended policy measures, or that Australia adopt UK-style regulation of terms of trade supplemented by local content requirements (p2). This is clear in LE's repeated claim that

> "Such measures can be justified … on the basis of the profound imbalance in market power between buyers and production companies as outlined in this report" (see pages 3 to 4, and page 34).

A fatal source of the problems with LE's use of market share statistics to justify its conclusions, and policy recommendations however, is that LE does not explicitly and clearly define the market it is analysing, or justify the *market definition* it is relying on to calculate market shares. This leads LE to make a fundamental mistake.

3.3. Market Definition and LE's Market Shares Analysis

In using the above IBIS market share data LE is clearly trying to draw a distinction between two markets:

- First, the FTA TV network market – where LE claims the four largest players account for nearly 80% of revenue; and
- Second, the IPTV and pay TV market – where LE claims the four largest players account for over 70% of revenue.

There are two problems with LE's analysis of market data (i.e. on revenue, market shares and concentration)

[19] IBIS World (2021) Motion Picture and Video Production in Australia Industry Report, p. 27

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1. Contrary to its claims, the data that LE analyses does not relate directly to the market LE purports to be studying, namely the market for film and TV production rights, where film and TV producers sell rights to content buyers, shown in the middle of Table 3.1 above. The above data instead relates to the final consumer market downstream (or at the top of the table presented earlier), as the data used is on the revenues of FTA TV, IPTV and Pay TV firms, which they earn from their final markets, shown at the top of Table 3.1 above. We will ignore this error by LE at this stage, and instead just assume for purposes of market analysis that the underlying data on *revenues* of firms in the final consumer market can be used as *a proxy* for their *expenditure* as buyers in the film and TV production market shown in the middle row of Table 3.1 above. There is still however a major problem remaining with LE's market analysis.

2. When LE analyses data for the FTA TV network firms and the IPTV and pay TV firms separately, the implication is that LE is assuming there are two separate markets – one for FTA TV network firms' services and another for the IPTV and pay TV firms' services. In doing this LE makes a common mistake of using too narrow a market definition for competition analysis purposes. Contrary to LE's analysis, the two markets implicitly being referred to, and analysed by LE separately, should in fact be analysed together, not separately, and once that is done (see below) the IBIS revenue data does not actually illustrate a high degree of market concentration relevant to competition analysis.

It is not clear why LE makes the second mistake and analyses the markets separately, especially when LE itself notes that

> "The whole sector is moving towards "convergence," as Internet delivered services compete with TV networks." Page 10

"Convergence" is just industry jargon for the economic phenomenon that Internet-delivered services and TV networks services are close substitutes, and therefore compete in the same market.

Economic theory is needed to properly define markets, and therefore measure market share and the degree of market concentration and competition, to give theoretical coherence and content to industry concepts like convergence. It is the degree of substitution that defines markets. Economics teaches us that if products or services are close substitutes then they are *in the same market*, and the products or services will compete or "converge" in the same market around one market price. The test used in economics to define a market thus involves starting with very narrow product definition (either FTA or IPTV), and then testing the effect of a small non-transitory increase in price (the so-called SNIP test) – usually assumed to be a 5% price rise. Take butter and margarine. If a SNIP for one product (butter), leads consumers to switch to other products as a result (e.g. to margarine), and suppliers of those other products (margarine) increase supply in competition with the product with the SNIP (butter), then all these products are close substitutes, and all trade in the same market (i.e. in the food spreads market).

As LE itself concedes in its report, in economic terms Internet Protocol TV (IPTV) or streaming and FTA and pay TV are in the same market, or "converge" and compete in the same market. Film and TV content distributed in Australia via IPTV or streaming services are close substitutes

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for film and TV content delivered using the traditional technologies adopted by FTA and pay TV firms.

Given FTA, IPTV and pay TV services are no doubt part of the same market, market shares should NOT be calculated for the combined market separately as LE does. The market shares of each should instead be calculated after combining FTA and IPTV and pay TV revenues to estimate the combined market's size. When one does this and analyses FTA and IPTV and pay TV services in one combined market, the level of four firms' market share, or concentration is clearly much lower than the 80% and 70% cited by LE. To illustrate, if one assumes the FTA and IPTV and pay TV services "market segments" are the same size (as they were in 2017-18) then in fact:

- The four largest FTA broadcasters in Australia (the three commercial networks and the ABC) only account for nearly **40%** of total combined or converged market revenue – not the 80% claimed by LE; while
- The four largest pay TV and IPTV players (i.e. Foxtel and streaming companies), would account for over **35%** of total combined or converged market revenue - – not the 70% claimed by LE.

In other words:

- The four largest FTA broadcasters would on average have only 10% market share each;
- The four largest IPTV and Pay TV players would on average have only 8.75% market share each; and
- Other firms combined would have 25% market share.

This is not a very concentrated market on the buy side at all. It certainly does not reveal a "profound imbalance" as claimed by LE.

3.4. Market Competition Increased: Shares and Concentration Declined

Indeed, the important conclusion to draw from the data presented by LE is that, properly interpreted, it in fact clearly shows the buy side of the market has become **more** competitive over time. It shows that concentration in the relevant market on the buy side has declined over time, and become more competitive, as a result of the disruption "by the internet, social media, and the entrance of streaming companies". When "buy side" market share is calculated using a proper market definition, the IBIS World revenue data clearly suggests that "buy side" market concentration has fallen.

This is further confirmed when one turns to the sell-side and considers the information obtained by LE from its interviews with producers, as follows:

> "LE's consultations with industry members have suggested that some members have benefited greatly from the entrance of streaming, shifting from almost a complete reliance on revenue from FTA networks to a reliance on streaming for 90% of their revenue, which they expect to be maintained into the next decade. However, some other members are still reliant almost exclusively (nearly 100% in some cases) on deals with FTA networks. An industry-wide survey would be necessary to provide definitive data,

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> but we expect that the trend toward greater revenue shares from streaming will continue, though it will be unequally distributed" LE page 11

Contrary to LE's claims, this sell-side or producer data also shows the market has become more competitive, with producers now being able to choose to contract not only with the traditional FTA and pay TV firms, but also with the new streaming firms, to obtain finance and distribution services for their films. As LE itself notes some producers have even been able to shift from almost a complete reliance on revenue from FTA networks to a reliance on streaming for 90% of their revenue.[20]

3.5. Substitution and Competition Between Streaming, FTA and Pay TV

If one further analyses the IBIS World revenue data over time (rather than market shares statistics), it also clearly confirms that film and TV content delivered in Australia using IPTV services or streaming, and using the traditional technologies adopted by FTA and pay TV firms, are close substitutes that trade in the same competitive market.

Thus, as LE highlights, IBIS World industry revenue estimates show that FTA revenues fell from around 6 billion in 2012-13, to about 4 billion in 2019-20 - or by 33% in 7 years. This decline in FTA TV revenue was largely offset by a compensating rise of revenue in the streaming and the pay TV industry segment, from just below 4 billion in 2012-13 to just below 6 billion in 2019-20. As a result of these changes, by 2017-18 IPTV and pay TV services together finally achieved higher revenue in Australia than the FTA TV networks - with IPTV or the streaming companies being responsible for the compensating growth rather than Foxtel (which has been losing viewers to streaming competitors).

In economic terms this data on FTA revenues falling while streaming revenues rise merely confirms that IPTV or streaming and FTA are close substitutes trading in the same market – and of course this is not a problem. In short, innovation has led to the development of new methods to deliver film and TV content to consumers in Australia, and consumers have switched to these new innovative technologies, from the traditional technologies used or from FTA and Pay TV services. None of this is a problem – quite the opposite. New entrants (e.g. Netflix and Amazon) have clearly been using innovative new technologies to enter the market for delivered film and TV content in Australia. This has in turn increased the number of competing distributers of film and TV content in Australia, and thereby increased the extent of competition or rivalry in market, not reduced it. This is good for consumers and producers. It has also led to consumers substituting streaming services for FTA services in some cases, increasing the choices available to them, which is also good for consumers.

Film producers have also clearly followed the lead of final consumers. Thus, at the same time as the above changes in the *final consumer market* occurred, "upstream" - in the *Australian film and TV production rights market*, revenues did not fall, if anything they increased slightly (see LE report Figure 1 p11 – and earlier evidence that growth has actually accelerated). This again disproves LE's hypothesis that the compositional change in consumer behaviour in the final

[20] LE Report p11

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consumer market outlined above had any negative overall effect upstream on the Australian film and TV production industry either.

3.6. LE does not Identify a Problem Justifying a Policy Change

Both the market share data in the *final consumer market*, and the market share data in the *Australian film and TV production rights market* relied on by LE then in fact clearly shows that the market is more competitive, and thriving. This clearly undermines the foundation stone for the LE policy recommendations, namely the central assumption or conclusion of LE that there is a "profound imbalance of market power" on the buy-side of the film production right market that

> "means that production companies may be pressured by the buyers which have more market power to accept poorer contractual terms than they would in a more competitive market among buyers" Page 10

Contrary to these claims of LE, both the buy-side data on revenue of commissioning firms, and the sell-side data for film producers relied on by LE itself in fact clearly show that the buy-side of the market has become more competitive based on market share data, and producers on the sell-side now have more choice, and continue to increase their total revenues. In this more competitive market, producers are thus now less likely to have to accept poorer contractual terms than they would have in the past, contrary to the claims of LE. They may however have traded off the much higher budgets and guaranteed margins offered by streaming companies for retaining fewer rights. In other words, they may have increased their probability of success with the higher budgets now on offer, accepted a guaranteed margin, but traded off (some of) the theoretical upside associated with that success.

Too narrow a market definition will always manufacture a competition problem that does not exist. In its efforts to identify a policy problem, LE wrongly assumed IPTV or streaming and pay TV were in a different market from FTA. On this basis as noted above it wrongly concluded buyers enjoyed "a profound imbalance of market power" at the expense of producers.

LE also frequently highlights a decline in free to air revenues in isolation as posing a potential problem for local film producers and policy as well. But in both cases LE is manufacturing a problem out of a flawed analysis of markets, in particular based on the wrong market definition, one that adopts too narrow a market definition.

From the outset therefore, LE simply do not make their case for a review of the law affecting the Australian film and TV production sector based on either a reduction in competition on the buy side, or a decline in revenues over time in Australian film and TV production (AFTVP) industry revenues since 2012/13. LE however tries to claim there is a problem with competition in the market, and the fall in FTA revenues, but that is because it is analysing data based on an incorrect market definition for the purpose of competition analysis.

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3.7. Changes as Just Legitimate Competitive Business Practices

At the end of Chapter 1 "Setting the Scene" LE points to the following changes in the terms of trade, and their causes as raising problems. The two changes in terms of trade that LE alleges have emerged both with FTA networks and streaming companies are:

1) **First greater cost control.** LE claims "*FTA TV networks …are seeking to cut budgets" (page 11)* and *"New entrants such as Netflix and Prime Video …appear to prefer a cost-plus commissioning model" (page 11)* and more generally *"With the rise of streaming, and with more aggressive FTA networks … we are seeing the imposition of a cost-plus model" (page 11) "in place of the upside that would otherwise be shared with content producers"* (page 12), and *"the margin on costs they have offered… has tended to fall."* (Page 12). LE claims that with *"streamers' strong preference for fee-for-service production' (page 5)* "*there has been an overall switch to what are effectively "work for hire" arrangements*" (page 12) *"the international streaming companies are showing a strong preference for work-for-hire with the offer to producers being, in effect, "take it or leave it."* (Page 11)

2) **Second extensions to rights.** LE claims *"FTA TV networks …are seeking to .. capture more rights for themselves… including rights to show programs on their own streaming services" (page 11.)* The "*more aggressive FTA networks seeking to secure as many rights for themselves as possible* "(page 11) Similarly *"streamers' strong preference for … full acquisition of rights"*[21] (page 5) *"Global streaming services generally seek to acquire all rights upon completion of a product in return for a one-off payment"* (page 11) with a specific example of such preference for exclusive rights *"Netflix has been reluctant to share data on viewership by program, so Australian production companies cannot know their contribution to Netflix's offering to viewers".* (Page 11)

In section 5 we will explore in detail the six categories of contract terms LE identifies in its report, addressing the extent to which they pose a problem, and LE's proposed policy to address them in more detail in later sections. Before proceeding to a detailed analysis of the contract terms, at this stage we will just consider an alternative explanation for the cause of the above two broad changes in terms of trade noted by LE a high level.

As we shall show in the remainder of this section the above two developments in contract terms do not seem to pose a problem, but rather look like nothing more than *legitimate business practices* and attempts to (1) reduce costs, and (2) increase revenues, or enhance the industries value add or efficiency. In "setting the scene" in section 1 of their report, LE however provides only two very limited alternative explanations for the above two changes, other than market power (which as we have seen is non-existent) as follows.

- For the FTA networks it is argued that the changes arise due to *"major revenue losses for their traditional broadcasting over the past decade*" (page 11), while

[21] LE provides no evidence for this claim. Streaming companies in fact use a variety of deal terms and structures. But even if this claimed preference were true, as we shall see it may simply be the most efficient way for the market to organise itself.

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- For the new entrant global streaming companies the changes are simply identified as " the *'streamers' strong preference"* (page 5)

This is made clear in the following direct full quote from LE:

> "The major changes we have witnessed in the industry mean that production companies are now dealing with:
> 1. FTA TV networks which have had major revenue losses for their traditional TV broadcasting over the last decade and are seeking *to cut budgets and capture more rights for themselves* in deals with production companies, including rights to show programs on their own streaming services; and
> 2. New entrants such as Netflix and Prime Video which have no historical long-term relationships with Australian production companies and *appear to prefer a cost-plus commissioning model where they take all the rights.* (page 11)

On the second claim, LE suggests that the change in terms of trade towards "*a cost-plus commissioning model"* where streamers' *take all the rights* simply arises from the "*preferences"* of the new entrant streaming companies. Apart from the fact that LE offers no actual evidence of its claims, LE does not seek to understand why such a preference may be warranted and indeed benefits consumers. The "preferences" of the new entrants – the streaming companies - could be best understood as driven by profit maximisation or loss minimisation. Given the market is quite competitive, indeed more competitive now, with public reporting highlighting significant losses being realised for some streaming companies as they seek to build market share, presumably then the new terms are simply more efficient and competitive business practices. These practices would likely be of benefit to consumers, who may enjoy greater consumer choice at more competitive prices. Consumers may then increasingly switch to streaming content and help the streaming companies survive and out-compete each other and the FTA networks. The FTA networks then have presumably also simply just adopted the same more efficient practices too, in order to reduce costs themselves, and compete to address the revenue losses of the FTA networks that in turn result from the competition from more efficient new entrants. Thus, competition may force both the streaming companies and the FTA networks to adopt more efficient practices. This is clearly not a problem for Australian consumers, or policy.

LE's analysis of the causes of the above alleged changes in terms of trade at this point in fact simply ignores (or obscures in the term "preferences") what is the more likely cause of change then, which is the new terms are just competitive market practices. Their adoption and spread may simply be better interpreted as efficient competitive behaviours to reduce costs and increase revenues to benefit consumers. Given we have ruled out the problem of abuse of market power, based on the data analysed and relied on by LE itself, the changes in terms of trade LE points to thus appear more likely to be simply an efficient response by the industry to the enhanced competitive conditions in the market. The evidence we discussed above is certainly consistent with this, or does not refute this hypothesis, but does refute LE's claims.

To the extent the new deal terms suggested by LE exist, ultimately they have clearly been pro-consumer, who can now access more content at lower prices at a time and in a manner convenient to them. One also has to acknowledge the extent to which they were likely to be necessary for streaming companies, given the high levels of uncertainty they would have faced entering a new market, with a new and still evolving technology and highly competitive landscape. The

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uncertainties streaming companies were confronted with in this new market were numerous, including:

- The link between subscription revenue and the viewing of a particular title is indirect. By comparison, in an FTA ad-supported model the link is very direct. Similarly, in cinema distribution it is also very direct. Therefore, attributing value for subscription-based streaming is much harder.
- Profit expectations would have been low and uncertain amid very real competition with other streaming companies and existing incumbents in the AFTVP industry, with most streaming services being loss-making (Disney+, Paramount+ losses are on the public record in their share market disclosures).
- The time between commissioning and releasing a show is long. More than 3 years can pass from commencement to release.
- The service was being rolled out globally.

Given these uncertainties and challenges, economic theory predicts that one might expect new types of contractual arrangements to be adopted by globally-focused streaming companies, compared to those of existing locally-focused incumbents (including the FTA broadcasters), as a more suitable or efficient way to organise a market that is still nascent, rapidly changing, and increasingly global. Economic theory further suggests that these contractual arrangements are likely to develop further as the segment matures, with, for example, more favourable terms for producers perhaps emerging as the segment becomes more profitable and stable, especially for the most in-demand projects.

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4. Market Power

Turning to Section 2 of the LE report, it is divided into three sub-sections

a) The first reviews the role and nature of contract terms, identifying six different kinds of terms;
b) The second reviews what it calls "The microeconomics of the industry" and distinguishes between market power and negotiating power
c) The third reviews problems with contract terms arising from abuse of market power and negotiating power

Section 2 b) provides the lynchpin or foundation for LE's analysis of contract terms, being it's claim in its summary at the outset of section 2 that

> "buyers very likely have <u>greater bargaining power</u> than production companies, and this will enable them to secure more rights than they otherwise would be able to." (page 10)

I shall thus address subsection 2 b) of the LE report in this section on market power and turn to review LE's detailed discussion of its six kinds of contract terms in subsections 2 a) and 2 c) together in the next section. Our analysis in this section highlights two further reasons why there is clearly not a profound imbalance of market power between buyers and sellers.

First of all, even if there were high market shares, or concentration ratios, low barriers to entry limit any attempt to abuse market power, as such abuse will be disciplined by market entry, and loss of market share to new entrants. LE does not identify or assess barriers to entry.

As we shall see a second reason why there is unlikely to be oligopsony market power is that it would require collusive or cartel behaviors by all buyers of content in the market. In an oligopoly, all firms would need to collude in order to raise prices and realise a higher economic profit. The reason for this is that the abuse of oligopsony power entails the oligopsonist firms as buyers forcing down market prices paid to those supplying goods or services to the market in order to make an oligopsony profit. Acting independently however, an individual oligopsony firm will always have the incentive to pay market rates to attract the best suppliers, giving them a competitive advantage over the other firms still paying below market rates. Thus the oligopsony behaviour alleged by LE requires tacit or explicit collusion. The abuse of oligopsony power alleged by LE would thus be hard to sustain in the current market, given the incentives for buyers of content to compete and cheat on any tacit or explicit collusive cartel agreement and capture market share off other cartel participants. LE did not even mention this need for collusive or cartel behavior, and consequently never suggested collusive cartel behavior even existed. LE has further provided no evidence of the existence of the necessary collusive or cartel behaviors between buyer firms to support its claim of an oligopsony power, and abuse of oligopsony power.

4.1. LE's Distinction between Market Power and Negotiating Power

A point worth addressing at the outset, however, is that in Section 2 b) LE distinguishes and separately discusses what it calls *market power* and *negotiating power* in the industry. As we shall see, the distinction between market power and negotiating power proposed by LE is a distinction without a basis in economics, and without a difference in terms of the purpose that LE

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uses it for. Thus we shall combine our discussion of these two ideas here in this section on market power.

LE at first defines market power as involving influence over price terms, and negotiating power as involving influence over other terms of the contract. One of the reasons LE does this appears to be a belief that in economics the use of market power only applies to influence over prices. But as we shall see this is not true. Price is just one term among many in a contract. Whenever market power exists and is exercised it might be directed at non-price terms, but even if it may seem to only be directed at price terms, other contract terms will inevitably also be affected by the exercise of market power. The exercise of market power over price will have to also involve the exercise of market power over other terms in order to keep them constant, or stop them adjusting to offset or undermine the exercise of market power over price. LE's analysis basically fails to analyse contracting in its entirety, or recognise that all contract terms are interrelated and together determine value received by buyers and sellers. It is not possible to look at the role and nature of contract terms as economically independent of each other. A lower price for a producer may be compensated in a greater volume of investment, higher expected sales, or revenues to a producer. Indeed, as we shall see streaming companies provide much bigger budgets than commercial or public broadcasters, and this may be the result of lower unit prices allowing greater quality, or unit volume to be purchased. Similar interdependences in contract terms exist in relation to risk. Under cost plus contracts for example producers face lower downside risks if the project fails, which gives producers greater income upfront than traditional contract models, while only reducing purely theoretical future income opportunities. On the other hand, the streaming companies who bear more of the risk receive more rights to compensate that they are better able to exploit, including longer contract duration, or wider contract coverage or scope (e.g. geographic or product market segment covered). Thus although LE distinguishes between the price terms of a contract from other terms, clearly price depends on other terms of a contract.

There is no point then distinguishing between market power and negotiating power on the basis of *terms* covered (price versus non-price), as market power has to be exercised over all contract terms at once. LE however also claims the *source* of market power and negotiating power are different. LE thus appears to claim that:

- Buyer market power is determined by the market shares of buyers, relative to that of sellers, while
- Buyer negotiating power arises due to buyer firms being larger and diversified.

As we shall show LE's analysis of the source of market power and negotiating power on this basis is also flawed. The table below nevertheless summarises the claims of LE that we shall review and assess and refute in this section.

Contract Terms	Type of Buyer Power	Source of Buyer power
Price Terms	Market Power	Low market shares or "in market" rivalry
Other terms	Negotiating Power	Large Firm size and diversity

The above table then summarises the following LE claims that buyers have "greater bargaining power" (p10) or "capacity to obtain better terms" (p18) for two reasons as follows.

1) First market Power – "Most simply, buyers have a degree of market power" (page 16

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section 2). LE defines market power "as it is normally understood in economic theory (which influences prices) (page 18) On page 16 of section 2 LE claims

> "Considering the microeconomics of the industry, its most salient structural feature is that content producers are mostly small" (on this claim *see comment in footnote below* [22]) "which means that they operate in a very competitive sector, and they sell to just a few large buyers …these structural features influence the economic and commercial dynamics of the sector….. Most simply, the buyers will have a degree of market power—that is, they will be able to influence the price paid in their own favour." Page 16

2) Second "negotiating power" – LE separately claims that buyers also have "negotiating power " "regarding the other terms" (i.e. other than price) because they are " larger and more diversified". LE thus claims that

> "the larger and more diversified buyer of content will be under less pressure to negotiate the deal. This dynamic seems likely to see them allocated a range of rights on account of the advantages that their size and diversification gives them in the rights negotiation rather than because they are necessarily the highest value owner of those rights. To distinguish this capacity to obtain better terms from market power, as it is normally understood in economic theory (which influences prices), we shall refer to it as the buyer's 'negotiating power'." Page 18

We discuss these two claims separately in what follows, and show the distinction is flawed, and the conclusions or predictions drawn on the basis of it are also flawed. In this regard it is useful to also note the critical economic consequences of what LE calls market and negotiating power, which it summarises at the outset of section 2 as follows:

- *"In complex negotiations for deals, buyers very likely have greater bargaining power than production companies and this will enable them to secure more rights than they otherwise would be able to. For instance,*
    - *TV networks are requiring AVOD or SVOD rights as a matter of course, and*
    - *streaming companies seek worldwide screening rights in perpetuity.*
- *These changes are*
    - *denying Australian production companies potentially large streams of future earnings from successful programs.*
    - *To the extent that the rights holders are now overseas-owned international streaming companies, these earnings are lost to the Australian economy. (page 13)*

As we shall see there are a number of key flaws in LE's analysis of market power and negotiating power undermining the above conclusions or predictions about the inefficiency of contract terms, or terms of trade in screen production, and their adverse economic consequences.

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[22] In fact, there is a mixture of firm sizes on the supply side, and of course the potential for larger sized firms to emerge on the supply side through merger and acquisition. The larger firms such as Matchbox, Curia, Fremantle, Hoodlum, Wildbear, often have diversified revenue streams, sometimes foreign-owned, who are thriving in this new environment.

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4.2. Market Power

To justify its assumption of oligopsony power, LE focused solely on *within market rivalry*, measured by *market shares*, or concentration ratio's, alleging that major buyers in the production rights market hold 70-80% market share. As we have shown in the last section in fact the market share data LE used did not however support the existence of buyer market power, or an oligopsony with greater bargaining power. Instead when properly measured buyers' market shares and the degree of concentration has fallen over time and is now quite low. As we have seen LE's calculation of market share was incorrect, and market shares of the top four firms has fallen to 35-40%.

Leaving aside LE's arithmetical error in calculating market shares, more importantly and more deeply concerning is that LE clearly assumes that the greater the market share enjoyed by fewer players, the more market power they have as an oligopsony. This is not necessarily true as market power depends on many other factors than market shares, and so LE's analysis is inevitably incomplete as well as mistaken. There are a number of important factors other than market share that determine market power in any market, including oligopsony power. LE does not explore these other factors that can mean high market shares are of no concern and this is what we focus on in this chapter.

As we shall see, there are clear limits to the ability for incumbent oligopsony firms to abuse any oligopsony power in the current market. Any explicit or tacit cartel action, or co-ordinated action by incumbent oligopsony firms, for example to lower the prices each buyer pays sellers, or the quality of other contract terms would fail as it would be subject to a number of effective checks.

- First is the ability and incentive for new efficient entrants to enter the market, which seems high in the current market. Indeed every year, there has been at least one new entrant into the streaming market. If incumbents abuse market power, a new efficient entrant could simply offer better terms than the incumbent oligopsony firms and take market share from them and restore a competitive market outcome. The threat of new entrants will tend to undermine and therefore deter any oligopsony, or cartel behaviour.

- Second a further primary problem for LE's analysis is that it requires collusive cartel behavior by incumbent firms. There is no evidence of this, and LE does not even acknowledge this point. The incumbent firms own incentive to compete and "cheat" on any explicit or tacit cartel agreement would have prevented collusive cartel behavior by incumbent firms happening in the first place. If a few buyers tacitly or explicitly were to agree to pay lower prices, or worse terms, then one of the buyers could always cheat in secret, and break out and offer more to attract the best talent or producers from others, as the more talented can produce greater value and are therefore more profitable.

- Other checks on the behaviour of smaller and large buyers includes the ability of the producers, and final customers to bypass the distribution companies, or
    - The ability of producers to distribute and market direct to consumers, and

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- For consumers to go to producers perhaps through new types of intermediaries, like YouTube and TikTok. [23]

As we shall see a further problem is that even if an oligopsony, or a few large dominant buyers might be said to exist, this is not necessarily a problem, as fewer large buyers may be more efficient and therefore good for sellers. LE claims that

> At least in theory, a 'perfectly' competitive market is the microeconomic structure that will arrive at the best possible division and distribution of rights. P18

But LE does not define what it means by a perfectly competitive market. LE seems to assume however that for all markets, "perfect" market competition requires a large number of buyers and sellers on both sides of the market. In economic theory, however, the optimal market or perfect market is the one that delivers the most for the welfare of Australians, or the most efficient results out of those markets that are feasible. If minimum efficient scale of buyers for a particular market is relatively high, then this may mean the optimal market structure is one with only a small number of large firms as buyers. At one extreme, only one firm may be able to supply the whole market at lowest cost, due to economies of scale leading to a monopoly being an efficient market structure. Rather than seeing the large scale of film and TV commissioning companies as efficient, and the Australian production rights market structure as therefore potentially efficient, and therefore "perfect" for Australia, LE claims the market is imperfect simply because of the size, number and market share of participants in the market, A focus on market structure, or simply counting and measuring the size of firms or their market share is not sufficient to establish whether a market is optimal, or to identify any market failure, let alone one that can be remedied by a Government intervention, and release benefits for Australians that justify the inevitable costs of Government intervention in the markets.

4.2.1. The Importance of Barriers to Entry

The critical requirement for market power that LE completely ignores is the existence of significant barriers to entry. Even if high market concentration exists,[24] this may not create market power or pose competition risks or scope for abuse of market power. It depends on whether new enterprises are able to enter the market if they are more efficient or more innovative than the established firms. In economic jargon, it depends on whether the market is contestable, or whether barriers to entry are low.

Market contestability is the situation where barriers to entry are low and firms can compete for the market. Even if one, or a few companies have a dominant position, or high market share, then this may not create a risk of abuse of market power including high prices, low output, and quality and lack of innovation, so long as there is high market contestability or low barriers to entry. As Tirole notes:

[23] Amazon opened as an online bookseller, on July 16, 1995 and has diversified into screen content and other products.
[24] Including oligopsony (a few buyers), monopsony (sole buyer), oligopoly (few sellers), or monopoly (sole seller)

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> If it is not possible to have vigorous competition between companies at a point in time, we must be satisfied with dynamic competition – or "creative destruction as Schumpeter called it – in which today's dominant firm is replaced by another that has made a technological or commercial leap""[25]

This is exactly what we have seen. The new streaming companies have made a technological and commercial leap. High barriers to entry however that prevent entry by new players competing for the market and limit the contestability or competitiveness of the market can be a source of competition risks, or prevent a market from reaching its full potential, leading for example to higher prices, lower quantity, poorer quality and lower innovation.

The classic economic definition of a barrier to entry is "a cost of producing (at some or every rate of output) that must be borne by firms seeking to enter an industry but is not borne by firms already in the industry." [26] More broadly they are barriers that prevent efficient entry.[27] A legal monopoly, privilege, tax or other advantage conferred by Government on an incumbent that new entrants do not enjoy constitutes a clear barrier to entry. Under this economic definition, capital requirements are not economic entry barriers unless the incumbent never paid them, and scale economies whether due to scale economies in costs, or benefits (e.g. network effects) are also not an entry barrier, provided entrants and incumbents have equal access to new technology.[28] From this standpoint, although the costs of establishing minimum efficient scale are a real cost of entry, they are not in themselves an economic barrier to efficient entry, or to competitive threat.

Thus even if LE were right and major buyers in the production rights market held 70-80% market share (which they do not), low barriers to entry can mean they do not have market power and/or cannot abuse market power, as if price, or other contract terms were held below a competitive level by the incumbents acting as a cartel, then (if barriers to entry are low), this would present a profitable opportunity for a new entrant to enter the market paying more to suppliers, but still being able to profitably operate and capture downstream business.

The distribution market involving streaming firms and major film studios clearly involves low barriers to entry. Thus contrary to LE's claim incumbent TV networks and streaming companies together should not be considered an "oligopsony," or a cartel able to sway contractual terms in their favour relative to what would occur in a less concentrated market. Given low barriers to entry there appears to be little scope for market power to arise and be abused in the distribution market involving streaming firms and major film studios - and so there is no need for regulatory intervention.

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[25] J. Tirole (2017) Economics for the Common Good" Princeton University Press p398

[26] See Stigler, George J. *The organization of industry*. Chicago, IL: University of Chicago Press, 1968 p. 67)

[27] Competition authorities often adopt wider definitions of barriers to entry (BTE) than covered in this classic economic definition. See for example. Competition Markets Authority (2013) *Guidelines for market investigations: Their role, procedures, assessment and remed*ies April 2013 pp45-50. The CMA adopts a much wider definition of BTE and expansion for purposes of its market investigations https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/284390/cc3_revised.pdf

[28] See McAfee R.P., Mialon H.M., Williams M.A. (2004) What is a Barrier to Entry? When are sunk costs barriers to entry: Entry Barriers in Economic and Antitrust Analysis AEA Papers and Proceedings May 2004 p461

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4.2.2. Government Subsidies, Ownership and Licensing Controls

Fiscal subsidies, government ownership guarantees and licensing controls affecting public service broadcasters (PSB) can provide advantages to these incumbent firms, not available to new entrants, and thereby create clear barriers to entry by new players, and market power in taxpayer subsidised, government owned and licensed media companies that is not enjoyed by other firms. Consistent with this problem the UK regulatory solution advocated by LE was only adopted for, and applied to market incumbents that enjoyed both the advantage of public subsidies and Government ownership - an advantage that other incumbents or new entrants didn't.[29] UK terms of trade regulation thus focuses on the British Broadcasting Corporation (BBC) in the UK, which is subsidised by TV license fees paid by British households, and also Channel Four Television Corporation which is a British state-owned media company headquartered in London that enjoys the benefit of a taxpayer guarantee as a result of Government ownership.

In short, the greatest likelihood of market power arises with firms that benefit from Government subsidies, government ownership and licensing controls, and accordingly these are the firms that were regulated additionally by the UK law administered by Ofcom. LE appears blind to the significance of this point, even though it acknowledges that in the UK the regulated

> Terms of Trade apply to PSBs and their digital channels, but not to streaming services, such as Netflix or Prime Video. P23

It is clear however the reason why UK law focused only on PSBs and their digital channels, was that these are the firms where the risk of market power was greatest due to the protection or barriers to competition, including barriers entry enjoyed by these firms.[30]

LE was also blind to the evidence that the same problem, namely PSB's potential to abuse market power, also appears to occur in Australia, in that LE itself found evidence consistent with this behaviour noting that

> We did hear of a firm that kept a 'league ladder' of the purchasers who were best and worst to deal with. We were surprised that the ABC was at the bottom of the list, p36

The fiscal, ownership and regulatory benefits enjoyed by ABC protects them from competition and confers market power on them, and is likely to explain this behaviour.[31]

Failure to recognise this key point of distinction between different firms in the market leads LE to make erroneous policy conclusions in relation to the rationale and applicability of the UK terms of trade regime:

[29] As a matter of clarification, the Australian Producer Offset (usually 30% of production budgets) which is available to producers selling to all commissioners - including streamers – is not relevant to this discussion as producers are not licensed, nor owned by Government (like the BBC in the UK, and ABC and SBS in Australia).
[30] Indeed, as noted above, PACT is not advocating for terms of trade to be applied to streaming companies.
[31] Political pressure to not be seen to be wasting taxpayer money may also contribute to this behavior.

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> Though the UK arrangements apply only to the major FTA broadcasters, there is *no reason* why a similar approach could not be adapted to the market for streaming content" page 36

4.2.3. Limits to Cartel Behaviour

Besides its failure to consider barriers to entry, a further problem undermining LE's analysis is that it assumes buyers are able to co-ordinate their actions - or act as a buyer's cartel, and engage in explicit, or implicit/tacit collusion, rather than compete. The problem with a buyer's cartel agreement (explicit or tacit) to increase prices, or the duration or scope of contract coverage for example is that any agreement is very unstable, or hard to co-ordinate, as there are very strong incentives for cartel members to compete, or "cheat" on any explicit or implicit/tacit cartel agreement. If incumbent buyers "agree" to all require inefficient terms on duration, scope or price setting, then it does not require a new entrant to break the cartel agreement up, as any one of the incumbents can easily "cheat", and offer better terms than the cartel, and expand or gain market share and profits, and tip the market against the compliant cartel members. This competitive "cheating" behaviour limiting the cartel's effects is hard to monitor or prevent, and is greater the more restrictive the cartel agreement is. Ultimately such competition is likely to undermine any cartel, triggering the breakup of the cartel as other members follow suit and compete, rather than lose further market share, while those who continue to comply with any cartel agreement face rapid decline of their market share, financial difficulties, and ultimately enterprise failure.

Greater market concentration amongst buyers, even if it existed, does not in itself imply an oligopsony causing adverse effects for Australian welfare. It may just reflect the higher minimum efficient size of the firms required to service the total market best. So Australians are better off with fewer firms that provide for diversity of preferences but do so at least total cost. The few most efficient firms then drive less efficient competitors from the market. Thus concentrated markets are not only common but are also likely to be efficient. The few buyers still compete intensely however, and have incentives to act efficiently, as any behaviour imposing a loss to Australian welfare poses an opportunity to make money by innovation or intense competition either amongst incumbents, or from new entrants.

4.3. Negotiating Power?

Finally, besides "market power" LE also appears to separately refer to what LE calls "negotiating power " as separately causing problems in the Australian Production rights market - over and above their assumed oligopsony power. LE claims the large scale and diversified nature of buyers in the Australian production rights market compared to sellers gives them negotiating power as follows

> "a large diversified firm negotiating with a smaller one is likely to have substantially more negotiating power" P17

Rather than basing this claim in economic theory LE appears to derive it from its interviews, commenting

> In our interviews, we encountered other features of the industry that are not captured in

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> the very simple schema above. The buyers of content are not only large but also far better placed to bear the risk that any given production will not succeed…. the larger and more diversified buyer of content will be under less pressure to negotiate the deal. This dynamic seems likely to see them allocated a range of rights on account of the advantages that their size and diversification gives them in the rights negotiation, rather than because they are necessarily the highest value owner of those rights *To distinguish this capacity to obtain better terms from market power, as it is normally understood in economic theory (which influences prices), we shall refer to it as the buyer's 'negotiating power'.* (p18)

As noted already LE's distinction between market power and negotiating power however is a distinction without a difference. In economics the use of market power does not only apply to influence over prices only. Price is just one term among many in a contract and is the focus of the economics of price theory, which is what most economists learn in their undergraduate microeconomic studies. But other contract terms can be affected by market power, and indeed inevitably will be, where market power exists and is exercised. I therefore do not distinguish market power from negotiating power on this basis. Market power subsumes the negotiating power concept LE tries to distinguish for the purpose of its analyses of negotiations over non-price terms, so I shall use the term market power to subsume LE's use of the term negotiating power.

Just to be clear however, it is worth clarifying in passing that the term "negotiating power" might instead perhaps be best or properly understood to refer to, and be reserved to describe a party's *bargaining power in a particular negotiation or setting* (rather than their market level power). But such negotiating power depends on a party's opportunity costs, or the alternatives they have available (leaving aside their use of market power, which they may or may not have, and which is best examined separately through a market analysis).

To the extent LE found in their interviews that large and diversified firms tend to have negotiating power, this is consistent with economic theory, but does not prove that they had market power, or imply that agreements they negotiate are in anyway inefficient, or likely to have adverse consequences for Australian welfare that are relevant to policy. A large and diversified buyer may just have relatively better alternative opportunities than a small and specialised seller/producer, and the buyers' stronger negotiating position is therefore just an efficient outcome.

Being larger and more diversified may first increase the value that such a firm can bring to a negotiating table, but also the number of negotiating tables that it might also turn to as alternatives, and therefore raise its opportunity costs, that sets a higher benchmark for what it will agree to or favourably influences the terms it can reasonably expect to realise in an optimal or efficient market. But this is not market power as used in economics. It is the value a party brings to the negotiating table, and their alternative opportunities (or tables) that drives the opportunity costs of a contract to both sides, and it is opportunity costs that determine the respective parties negotiating or bargaining power. But this does not mean there is a problem arising from negotiating power or bargaining power, unlike the many problems economics predicts may arise with market power that as noted is better-assessed using market level analysis of barriers to entry and market concentration.

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Basically LE presents a flawed economic analysis of the relevant microeconomic dynamics underlying the large size and diversity of buyer firms. LE claims

> The buyers of content are not only large but also far better placed to bear the risk that any given production will not succeed…. This dynamic seems likely to see them allocated a range of rights on account of the advantages that their size and diversification gives them in the rights negotiation, rather than because they are necessarily the highest value owner of those rights p18

Contrary to LE's suggestion at the end of the above quote, large and diversified buyers or funders of content are likely to be the highest value owners of a wide range of rights. The problem is that LE does not adequately explore the first sentence above, and accurately analyse the reason why buyer firms are large and diversified. This is clearly due to the fact LE mentions in passing at the outset, large and diversified makes buyer firms "better placed to bear the risk that any given production will not succeed". Given the risks associated with the content industry and the benefits of risk pooling, or diversification large and diversified is the type of business best able to succeed in a competitive market.

There are many ideas for content in the screen industry, but very few succeed, and screen content is also expensive to produce. Thus although content financiers and commissioning companies may know the underlying distribution of the probability of success overall, and therefore that it is possible to expect to make profits on average, they do not know the particular realisation of the underlying distribution in any given piece of content. If however the risks of success or failure of different content are independent, then large and diversified firms will tend to be more efficient and succeed, as they will be able to pool and spread risks across a larger, more diversified portfolio of content.

Large and diversified buyers are thus an efficient outcome and the result of competition. LE does not appreciate or understand that large and diversified buyers are an efficient outcome that does not pose market-level or contract-level problems. Contrary to LE's suggestion, large and diversified distribution firms are likely to be the highest-value owners of a wide range of rights, as they are better placed to bear the risk that any given production will not succeed, and indeed that is one of the main reasons they are large and diversified, it is a more efficient form for content funders and distributors.

LE also does not adequately acknowledge that large and diversified companies also use current income to invest in new content, nor why this is rational behaviour. This phenomenon can be explained due to asymmetric information. In short, commissioning companies are likely to be a better judge of returns on investment in current films than outside investors. This means internal financing done out of current income, rather than external finance, entails a lower cost. Thus, revenues from older works under an extended contract term will be used by commissioning companies to expand investment into new films and TV recordings and in the development of new and existing film and TV products.

Large and diversified buyer firms are therefore an efficient outcome, and such firms will face rich opportunities for good reasons, as they are more competitive. It is the opportunity costs buyers and sellers face that determine the respective parties negotiating or bargaining power.

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5. Economics of Contract Terms and Abuse of Market Power

In this section we discuss LE's description and analysis of specific contract terms in section 2a) and 2c) which constitutes about 16% of the main report. In section 2a) LE briefly discusses the role of contract terms noting

> "The contract terms negotiated between … buyers of content and their producers determine how costs and risks are borne…it is no surprise that the terms of those contracts are fundamental to the health of individual firms and the industry"

and then claims

> "For reasons that will become evident … in the next subsection, we think it is useful to group the various terms of contracts according to the categories below.

LE then lists the following six categories of contract terms, and includes a brief discussion under each - one by one- over three pages constituting nearly 10% of the main report

> 1. Rights governing the sharing of the burden of production.
> 2. Rights governing the sharing of the benefits from short to medium term success.
> 3. Rights to control the longer-term commercial trajectory of the creation.
> 4. Long tail or residual rights.
> 5. Rights mitigating competitive threats to the funder.
> 6. (Defacto) rights to behave unreasonably."

Later in section 2c) LE discusses what it calls "Problems with Contract Terms" using the above list of six categories, one by one - over 2.5 pages.

LE describes the significance of the six categories as follows

> "as one moves down the six categories of rights identified in earlier sections, the top two or three are fundamental to the economics of projects, whilst the bottom three are much more marginal to the attractiveness of projects" (page 27)

LE qualifies this last statement however in a footnote somewhat confusingly or incoherently:

> "This is not necessarily literally true of the last category of rights—those which can be opportunistically seized by the stronger party on unreasonable grounds. But however much such rights might advantage those exercising them in the short term, they are likely to do more harm than good, all things considered. Accordingly, we do not accord them value. (footnote 16 Page 27)

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5.1. General weaknesses in LE Analysis of Contract Terms

Contract terms were meant to be the focus of Lateral Economics (LE) report. This is what LE was engaged by the Screen Producers Australia (SPA) to study, as reflected at the outset of the report in the description of LE's brief from SPA, found in section 1 as follows:

> Lateral Economics has been engaged by Screen Producers Australia to study the *contract terms which Australian production companies supply buyers of their content*, including but not limited to free-to-air broadcasters, Foxtel, and streaming companies such as Netflix, Prime Video, and Stan. (LE page 9).

The italicised phrase in the brief *"the contract terms which Australian production companies supply buyers of their content"* does not really make sense, as production companies do not supply contract terms. Presumably this phrase was meant to read something like *"the contract terms under which Australian production companies supply buyers of their content"* - a simple typo perhaps.

In general, however, LE does not provide a coherent let alone complete discussion of contract terms, or terms of trade in section 2 a) and c). The lack of coherence and completeness of LE's discussion of contract terms, or terms of trade in section 2 a) and c) is manifest in a number of ways as we shall discuss below.

5.1.1. LE Fails to define Basic Concepts

As we shall see, a central problem is that LE does not define relevant underlying key legal concepts it is relying on, like contract terms, contract rights, and obligations. Nor does LE explain the relationship between these concepts. It also does not clearly relate underlying legal concepts like contract terms to relevant economic theory and key economic concepts of primary interest such as costs, revenues, profits, prices, volumes, demand, supply, consumer welfare etc., so as to enable one to derive the economic problems LE claims to have unearthed, or the relationship between the alleged economic problems requiring a change of law and the contract terms. In other words, the analysis presented by LE is thus not well grounded in either legal theory or jurisprudence, or economic theory.

For example, LE does not distinguish contract rights from obligations. Rights define relationships between people with respect to something. Rights are optional entitlements to make decisions and take actions that typically involve costs and benefits to the right-holder, and to others affected. Typically rights resolve conflicts involving scarce resources, and are therefore reciprocal so if a right to something is allocated to one person, it is denied another, and implies an opportunity cost for the person bound or affected. Rights consist of many elements, but classically in law three broad elements are distinguished. These are

- The right to use,
- The right to income and
- The right to transfer.

LE does not draw on this legal way of defining and categorizing rights. Instead, as we shall see, it does not seem to use any formal recognised method at all.

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Obligations on the other hand are duties to make decisions and take actions that also typically involve expected costs and benefits to the bearer of the obligation, and to others affected. LE makes no reference to contract obligations at all, although they form a key part of any contract and of contract law. Indeed, LE instead clearly confuses contract rights with contract obligations. Thus, one of the sections dealing with legal rights is entitled "Rights governing the sharing of the burden of production". But one is most likely to share in a contract burden via a contract obligation - not a right.

As noted LE also fails to define how rights (or obligations) of production affect parties economically in terms of direct and opportunity costs, or foregone profits, nor clarify terms on units or volume of production, nor how any burden is shared in terms of price terms, or what form the price terms take, although prices can take many different forms like payment of a fixed amount, or a variable amount, input based (cost-plus), output based (e.g. retail minus), as a percentage (as in royalties), and may entail recoverable and non-recoverable advances, etc. Different price terms or forms of pricing impose different burdens on buyers and sellers.

As we shall see, as a result of its failure to define basic concepts or terms, section 2a) and 2c) are incoherent, and do not establish what they purport to – e.g. that "prices may be too low". LE basically does not make clear the nature of the underlying transaction or parties involved in the contracts, or the terms LE is categorising, making it hard to verify or assess the nature and extent of problems it alleges.

5.1.2. LE Misuses Economic Theory of Contract

The analysis of contract terms presented by LE in section 2 involves what economists call an "economic analysis of contracts", which in turn is a subtopic in the more general subfield of economics called "law and economics" including "economic analysis of law".[32] LE however fails to reference, draw on or even relate its analysis to the basic insights and principles developed over many years in law and economics. As a result, LE inevitably presents a very poor economic analysis of contract terms, and contracting.

This fundamental weakness in LE economic analysis of contracts and law can best be illustrated by its failure to draw on the insights offered by the so-called Coase theorem in economics, attributed to Ronald Coase, a central figure in the development of the subfield in economics called law and economics. Coase won the Nobel prize for "his discovery and clarification of the significance of transaction costs and property rights for the institutional structure and functioning of the economy". This gap leads LE to make a fundamental mistake in its analysis in section 2 that recurs throughout, and undermines its detailed analysis of the nature, role and problems with contract terms. This can best be highlighted at the outset by the fundamentally mistaken claim upon which all of LE's later analysis is based in section 1 on page 17, where LE claims

> With the terms of the contract dividing and structuring the benefits of the project, economic theory tells us that the 'right' owner of any given right is the party which is

[32] Ronald Coase claimed law and economics can be understood to have two parts, the first the use of the economists' approach and concepts to analyse the working of the legal system, often called the economic analysis of the law; and the second the study of the influence of the legal system on the working of the economic system. He was most interested in the second part.

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> capable of turning it to its most valuable use…. what we call the 'highest value owner' of the rights ….At least in theory, a 'perfectly' competitive market is the microeconomic structure that will arrive at the best possible division and distribution of rights. This is because, at least in principle, as the parties negotiate who has which right, the party that can put it to its most valuable use would be prepared to give up more than the other party to obtain it, and so, in a fair and rational negotiation, they will end up with it.
>
> However, there are two major obstacles to this benign outcome. First, it will often be highly uncertain (even to the parties themselves) precisely how to divide up the rights and which of them is the 'highest value owner' for each right. This effect will only become more pronounced the further ahead the parties are looking. Second, a large diversified firm negotiating with a smaller one is likely to have substantially more negotiating power—a subject to which we now turn. Page 17

In short economic theory does not "tell us" or support the above claims by LE at all.

1. First as we shall see LE's claim that "in theory a 'perfectly' competitive market …will arrive at the best possible division and distribution of rights." is just unhelpful and irrelevant. As Ronald Coase pointed out over 60 years ago, the perfectly competitive market that LE refers to simply does not exist. Given 'perfectly' competitive markets do not exist, they cannot generate the best possible outcome as proposed by LE. In economic theory, the so-called perfectly competitive market is in fact only a model, or a "nirvana", the equivalent of a model of a frictionless environment in physics, one that cannot be applied to the natural world on earth, where there are frictions. In the same way the physical world has friction, so too do markets. In economics the friction or sand in markets is called transaction costs, i.e. the direct and opportunity costs of consummating exchange. Transaction costs in market exchanges can then prevent the transfer of rights to the highest valued owner. Coase defines transactions costs as the costs of finding contractual partners and writing, monitoring and enforcing contracts. The perfectly competitive market model in fact assumes zero transactions costs, or a zero transaction costs world. As Coase notes, however, transactions costs in fact exist in real markets like the one LE was meant to study, and transaction costs may exceed the value from an exchange, and thus prevent an exchange. Thus if the marginal gain in value (V) arising when a right is transferred to the "highest value owner" (HVO) from a lower value owner (LVO) is less than the transaction costs (TC) of making the transfer (ie $V_{HVO} – V_{LV0} < TC$), then the transfer will not occur, and it would be best for the right to remain where it is, with the lower value owner. As we shall see, LE fails to appreciate this feature of real markets, as opposed to perfect or nirvana markets, and this fundamentally undermines the economic analysis of contracts it presents. LE therefore presents no basis on which to judge what is best, or what is wrong with the contract terms LE analyses in section 2

2. Secondly, economic theory, and in particular the Coase theorem, identifies transaction costs as the obstacle to exchanges - and not the two obstacles cited by LE, which if anything are subsumed within the definition of transaction costs. Building on Coase's insights, Nobel Prize winner Oliver Williamson identified the deeper causes of transaction costs to lie in features of the environment, and features of human beings. The environmental conditions include information costs, and so-called asset specificity, while the relevant human conditions are bounded rationality and opportunism (or self interest

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seeking with guile). Thus, LE's first obstacle of uncertainty, identified in the above quote from page 17, arises from the existence of information costs and the bounded rationality of human beings, which together mean humans can't readily predict the future. Uncertainty is thus subsumed as a cause of transaction costs. LE's second obstacle, however, namely the alleged negotiating power arising when a large, diversified firm is negotiating with a smaller one, is not in fact an obstacle to exchange, or to rights moving to the highest valued owner, in the absence of transaction costs. A large and diversified firm will transfer a right to a smaller but higher value owner (HVO) of the right, if the HVO can pay them for their direct costs and opportunity costs from the exchange (i.e. if $V_{HVO} - V_{LV0} < TC$). Experimental tests of the Coase theorem have produced results consistent with this prediction. Thus the results of studies of actually bargaining between parties are consistent with the Coase theorum that the parties will transfer rights if the value of the exchange exceeds the transaction costs of exchange. LE's proposition about large, diversified firms negotiating with smaller ones is fundamentally flawed, as we explored in the last section.

5.1.3. Unclear Basis of LE Six Categories of Contract Terms

A further fundamental general problem is that LE does not elaborate how it derives the list of six categories of contract terms it analyses in section 2. The only explanation offered before the six categories are listed by LE is the following:

> *For reasons that will become evident* when we explore the microeconomic dynamics of the industry in the next subsection, we think it is useful to group the various terms of contracts according to the categories below. Page 13

The reasons for the six categories do not, however, become evident later in the report. The basis of the six categories is not clarified or derived in the next subsection or elsewhere in the report. It is also not self-evident, and needs to be explained.

The categories clearly do not appear to be based in economic theory or legal theory or jurisprudence as noted above. Nor do they appear to be derived from a detailed empirical analysis of a representative selection of contracts over time. The only reference to source information and methodology on the six categories is found in LE's discussion of category two and category six, where LE says "We heard of" (p16) and "we also heard of" (p25). More generally, in its section on negotiating power discussed earlier LE also referred to what it found "In our interviews". If empirical research involving interviews was conducted however, LE does not indicate who and how many people were interviewed, and how many contracts if any were analysed, of what value, covering what time period, what type of production and what share of total production value. I acknowledge that it may be hard for LE to present certain evidence given the confidentiality of contracts. But this does not prevent formal statistical analysis of aggregated data to quantify the issues or LE's claims, using, for example, simple percentages or anonymous aggregate information about the survey being presented. In the same month that LE's report was released, SPA released the results of a Commissioners Survey, [33] and there is no justification for the input

[33] https://assets-us-01.kc-usercontent.com/89c218af-4a5a-00a2-9d83-3913048b3bc7/37bc3bb1-e880-459b-aa0a-248c02a49c9d/Commissioner%20Survey%20-%20SPA%202021.pdf.

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from this process not flowing into the LE report. That report, in fact, shows that streaming companies are receiving the best report cards from producers, relative to other commissioning sectors.

The six categories thus appear to have been invented by LE, based on what it heard in a limited number of interviews. This is highlighted most clearly in the fact LE does not anywhere define what it means by a contract term. LE also does not demonstrate any depth of understanding of contract law and legal contract rights. For example, some of the most important contract terms are those that determine

- The parties involved
- The scope and nature of the parties mutual rights and obligations including
  - Definition of the consideration, products or services to be exchanged
  - Product, or service rights and obligations
  - Delivery rights and obligations
  - Payment rights and obligations
  - Warranties
  - Geographic or Jurisdictional coverage
- Duration of the Contract
- Dispute Resolution
- Damages
- Termination
- Force Majeure
- Confidentiality

LE does not make clear the nature of parties involved in the contracts, the underlying transaction, or the terms LE is categorising, making it hard to verify or assess the nature and extent of the problems it refers to. This was essential to making its case. Its list however was clearly incomplete and leaves out important issues. LE for example only makes vague references to the many relevant parties who have rights under the relevant contract terms, with no clarity or consistency in the use of terminology. Thus LE refers to:

- Distributor(s) – there are 2 references to distributors - “Film distributors” (p17) and “A distributor of films in Australia” (p17)
- Commissioner(s) - there are 2 references, one to “terms of trade between producers and commissioners” (p31) and another to “model commissioners of content” (p36)
- Funder(s) – there are 30 references to either a “funder” (14), or “funders” (15) and “a funder’s” (1) – including both generalists and specialists e.g. “another funder from Britain” (p17)
- “coalition of funders” (1)
- Buyer(s) – there are 56 references either to “buyer” (14), “buyers” (41) or buyer’s (1) - both generalist and specialist e.g. “content buyers”
- Streamer(s) - there are 26 references either to “streamer” (2) or “streamers” (26) - both generalist and specialist e.g. “global streamer” (4)
- Broadcaster(s) - there are 40 references to Broadcasters
- FTA – there are 40 references to FTA, 5 to FTA broadcasters
- Pay TV – there are 4 to pay television and 4 to Pay TV
- IPTV services – there are also 5 references to IPTV services, or segment providers

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- Producer - there are 73 references to "producer", 16 to producers (56) or producer's (1) both generalist and specialist e.g. "screen producer" (15)
- Production companies - there are 37 references to production companies both generalist and specialist e.g. local production companies or UK production companies

Due to the so-called doctrine of privity of contract in law, contract terms or contract rights and obligations can only be enforced inter se, or by, and between the parties to the contract. So a particular problem contract term, or problem with a contract term identified by LE may not affect all the above parties, indeed it may only affect one or two of them, and be of limited consequence to all others. LE not only fails to make very clear what parties are involved in the contract terms, it does not clarify the respective roles of the parties – or ultimately who has what rights (benefits) and obligations (costs) amongst those being discussed, and how they are enforced. LE also does not make clear whether perhaps there are multiple parties involved in the contracts, contracting either bilaterally or multilateral, in perhaps multiple interdependent contracts covering different issues. There is however one reference to a "coalition of funders."

LE simply presents and discusses only six contract term categories. This could not be said to provide a complete coverage of all relevant contract terms. LE presents a list that does not enumerate a reasonable full list of key contract terms, let alone potentially categorise them all - nor it seems as we shall see even incorporate only contract terms.

As noted LE basically does not make clear the nature of the underlying transaction or parties involved in the contracts, or the terms LE is categorising, making it hard to verify or assess the nature and extent of problems it alleges.

5.1.4. LE Fails to Consider Legitimate competitive business practices

As we shall see all of the problems listed by LE in relation to specific categories of terms could be explained as the efficient outcome of competitive market processes and legitimate business behaviour. That is, they could be explained by the profit-maximising behaviour of both parties and their attempt to maximise joint value over time in a competitive market, subject to transaction costs. LE instead interprets them solely as the result of anti-competitive behaviour in a manner that assumes there is a problem rather than proves there is one, and may simply reflect confirmation bias.

5.1.5. LE Fails to Consider Contracting in its entirety

One has to look at contracting in its entirety. A narrow focus on only one term in a contract such as duration or scope may lead one to ignore how changes for example on duration (that may adversely affect producers) are offset by a change in price, or in the volume of demand for services at any price, that taken together may leave producers "whole", or more than compensated for any adverse change in the duration term. There may thus be no net economic effect between producers and commissioning firms of a change in one term, after one considers *contracting in its entirety*, due to compensating changes in other terms or even after one considers changes in the commercial relationship between contracting parties over time. LE does not look at contracting in its entirety. Instead, LE identifies six ill-conceived categories of contract terms, and then focuses its analysis on discussing problems with each category narrowly and separately one at a time,

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ignoring interdependencies and cross effects both between the terms LE analysed, and with terms that are not analysed by LE. The service performed by a producer and the profit they earn for a production is defined by all the terms of the contract under which it is produced. Contracting thus has to be examined in its entirety, with regard to the contract's total effect on each party over time, as a cost under one contract term may be offset by compensating changes in other terms over time.

5.1.6. LE Fails to Adequately Consider Contracting Over Time

Contracting also has to be examined over time, particular where one has repeated business relations or relational contracting (see below), again having regard to total effects on each party over time, as a cost under one term at a point in time may be offset by compensating changes in other terms over time. This is best explored along two dimensions:

i) Expected Net Present Value or Revenues and Costs Over time including the net value of options
ii) Risk and Uncertainty due to Volatility over time

LE thus fails to adequately distinguish short term one off transactional contracting, versus long term or repeat relational contracting. The latter form of contract may see worse terms in a one contract being offset by the expectation of repeat business of better terms in another over time.

5.2. Specific Problems with each of LE's Six Contract Term Categories

LE identifies six specific categories of contract terms that it claims give rise to problems

1. Rights governing the sharing of the burden of production.
2. Rights governing the sharing of the benefits from short to medium term success.
3. Rights to control the longer-term commercial trajectory of the creation.
4. Long tail or residual rights.
5. Rights mitigating competitive threats to the funder.
6. (Defacto) rights to behave unreasonably."

In this section we briefly summarise the results of our review of LE's analysis. For this purpose we simplify the six categories of rights identified by LE, into three as follows

A. Rights governing the costs and benefits of production.

LE does not draw a clear distinction between the first two categories of rights (1 and 2). In essence, however, the first relates to how the costs of production are shared, while the second relates to how the benefits of production are shared. Together they determine the profits (benefits less costs) earned by the parties, and their incentives to engage in optimal production and investment in quantity and quality. We shall thus summarise our conclusions on LE's analysis of these two categories of rights together in light of their combined implication for incentives and behaviour. In this regard, LE claims that recent changes have led to a situation where, on the one hand, producers are allocated too great a share of the costs (in 1), and on the other too little share of the benefits (in 2). The key implication from LE's analysis then is that producers as a result are now unable to make sufficient *profit* (benefits

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less costs) from production to justify an optimal investment in quantity and quality. The *cause* of the problems LE raises on each issue (1 and 2) however is the same, namely that buyers are abusing market power in each case. As we have shown already, however, buyers do not have market power, so LE has not established a foundation for its claims. In this section we therefore explore alternative explanations for the alleged changes in the allocation of costs and benefits, and conclude they are likely to be the beneficial result of greater competition, and not the abuse of market power.

B. The Scope and Duration of Rights

LE's third and fourth categories (and elements of the second) in essence involve a concern with regard to the scope and duration of rights assigned to producers, In particular, LE is again claiming that buyers are abusing market power, and that the scope and duration of rights allocated to producers are not socially optimal, in that

- the scope of producers' contract rights are too narrow (3 above), and
- the duration of producers' contract rights are too short (4 above - which is really related to 2).

However, as we have already shown, buyers do not have market power. In this section we therefore explore alternative explanations for the alleged changes in the scope and duration of rights, and conclude again that they are likely to be the beneficial result of greater competition, and not the abuse of market power.

C. Rights over Preparatory Content or Development work

The last two concerns raised by LE (5 and 6 above) in fact involve two different types of problems that are however both related to development work on preparatory content undertaken during the initial stages of production.

LE's fifth concern arises when development work on preparatory content is halted and further exploitation ceases, leaving behind a developmental asset that can become "stranded". LE notes that often contracts to fund development include clauses to ensure that the development of content can be passed on to another party in return for complete or partial compensation of prior costs of the development. However, contracts can also contain last matching rights and other rights to delay further production— for instance, the development of a further series – and as a result no further development occurs. LE raises the public policy concern that such contract terms may be too restrictive of competition, and impose costs on third parties as a result.

LE's sixth and final concern arises when funders have already agreed to terms, and preparatory content or development work has started, and then funders add further burdens onto producers who have already invested time and resources into the project that are now sunk costs, and give rise to a risk of "hold up" by funders, who may seek to essentially extract better terms, knowing a producer may have little alternative but to write off the sunk costs, and accept the new terms. LE raises the public policy concern that such conduct by funders may be unreasonable or unconscionable, and inefficient to the extent it may deter or reduce investment in production at the outset.

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In what follows I briefly discuss each of these three specific contract problems (A to C above) raised by LE in turn.

5.2.1. Rights governing the costs and benefits of production.

There are two main problems raised by LE under this category:

- Prices paid to producers are too low; and
- Producers bear too much risk.

We discuss each of these claims in turn.

i) "Prices are too Low"

LE's focus is on prices paid producers. In its contract terms category 1, LE claims that

> **Prices may be too low:** .... somewhat lower than the level that would be regarded as ideal, in economic theory. (page 24)[34]

In its contract term category 2, LE also refers specifically to "What Royalties, fees, or other funds might be paid to producers" (in other words "prices"), again claiming these are low, or less than ideal.

In both cases, LE claims these low prices and payments to producers arise from the market power of commissioners or buyers of content. We have shown, however, that the market is competitive, market shares are low, there are no barriers to entry, and cartels would be hard to sustain in the market. LE's prediction that prices are too low is thus based on a flawed theory that is refuted by the evidence discussed earlier. If, however, LE may have "heard" in its interviews that producers may feel under "price" pressure, then as we have discussed already, the real reason is probably the greater competition in the downstream final consumer market now, which may be driving down the prices *consumers* have to pay for access to content, and thereby could be putting pressure on producers to provide greater value for lower cost, or innovate and be more efficient. More pricing pressure would mean only efficient firms survive. This is good for the welfare of Australian consumers.

As producers as a whole may become more efficient due to greater competition, "prices" or payments to producers may perhaps fall, with more efficient firms surviving the greater competition. To the extent demand is elastic however (which seems likely), then as the market "prices" of works fall producer revenue will nevertheless increase, as the volume or quantity demanded will expand to more than offset any price fall. Lower prices would thus not always be a bad thing for producers as a whole. It depends on the efficiency of the producer and the elasticity of demand, which appears elastic and therefore rewards a given percentage fall in "prices" with greater percentage increases in quantity, and therefore higher total revenues. Prices falling are

[34] The rest of LE's discussion of this first type of contract term does not refer to any other problems but rather refers to two arms of Government policy, namely local content requirements and second, screen tax offset provisions

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therefore not automatically a problem for Australian consumers or producers as a whole.

LE simply does not provide sound reasons why, nor evidence to show, that "prices" are too low or less than ideal. Indeed it is worth noting that LE does not even make clear what "prices" it is referring to. Any such "prices" however have to be understood in the context of a content production deal, which involves *budgets*, often for creative activity by teams, with many components to any overall budget, and many parties having a role to play. As Screen Australia notes:

> Making profit from TV drama production, first and foremost, depends on the success of the show internationally. After that, each component of a show has to be examined – the advance, the budget, the way revenues flow – not just on a show-by-show basis but also from the point of view of each player in the chain.[35]

Given LE's brief from SPA, however, LE's reference to "prices" presumably refers to production *budgets*, that Australian production companies receive or are paid by "buyers of their content" or commissioners.

Contrary to LE's assumptions, greater competition from global streaming companies with global reach and greater economies of scale have led to bigger budgets for initial productions, and brought on line more marginal sequels over time, with even greater revenues and profits over time as a result. Consistent with this analysis it is clear budgets have gone up – with streaming companies' commissions being up to 4.4 times higher than commercial TV.[36] In FY21/22 the average hourly cost for an SVOD production was $3.3m.[37] Mini-series on Television – often with rest-of-world co-investment from streaming companies - had average hourly budgets of $1.7m, and across their total investment the average cost per hour was $0.7m.[38]

ii) Producers bear too much Risk

The second type of problem that LE refers to is that producers are being forced to bear a greater burden of downside risk. On this point LE only makes specific reference to producers being obliged to buy insurance, with the purpose described vaguely to cover "various potential liabilities". What is not made clear by LE however is that if the insurance premium is explicitly or implicitly included in the amount budgeted for production, then once this budget is paid in full by a commissioner, the producer does not in fact pay for the insurance premium, the party funding the budget does. Moreover, once the insurance premiums are paid out of the budgeted funds provided, any insured risks then in turn pass to the insurance company under the insurance policy, not the producer. Being obliged to buy insurance then does not mean producers are being obliged to bear a greater burden of downside risk.

[35] https://www.screenaustralia.gov.au/sa/screen-news/2016/06-28-tv-drama-abroad/part-1-when-do-tv-sales-become-profits
[36] https://www.screenaustralia.gov.au/fact-finders/reports-and-key-issues/reports-and-discussion-papers/drama-report
[37] ibid page 24
[38] ibid page 18.

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Elsewhere LE indeed claims budgets tend to be "Cost Plus", in which case budgeted insurance premium(s), would be fully funded by the commissioner, buyer or funder. Thus producers in effect do not pay for the insurance premiums, nor bear the "various potential liabilities" LE cites. LE thus does not explicitly establish that producers are bearing a greater share of risk. If anything. by claiming that streaming companies have a preference for "Cost Plus" deals, LE implies that all risk is assumed by the commissioner, as all costs are covered by the commissioner, "*plus*" a margin paid on top of cost - with the "plus" in cost-plus pricing methodology of course being calculated to compensate producers for any risk they do bear.

iii) Conclusion

Bringing the discussion of contract terms related to "prices", costs and risk together as we have done here, provides a good illustration of why one needs to consider contracting in its entirety – or in other words consider price, cost, risk, benefits and other terms together to assess their implications for profits and therefore incentives. Even if LE is right, and prices that producers are paid by content buyers are under pressure, these weak prices may be offset by the fact that a greater amount of risk is now being assumed by the large global buyers under cost plus pricing methodologies, rather than by the producers. In a competitive market this outcome where commissioners, funders or streaming companies bear more of the risk is consistent with the fact risk is likely to be best carried by them. Changes in prices and royalty streams (and licensing scope and duration - on which see next section) may simply be a reflection of the changes in risk assumed by these commissioners, with consumers the ultimate winners as they enjoy more and better quality content at lower prices by more convenient means.

5.2.2. The Scope and Duration of Rights

A production contract not only covers the allocation of the costs and benefits of any production as discussed above, but also the allocation of property rights in the final product. Property rights are in fact a bundle of rights that may be traded, altered or transferred by contract terms. As noted earlier the three broad elements to property rights classically distinguished in law are:

- The exclusive right to use an asset;
- The exclusive right to income; and
- The exclusive right to transfer the above rights.

These elements may further be broadly characterised by their:
- Scope, or breadth (e.g. what sub markets, or derivative products are covered etc.) and
- Duration (e.g. the time period any rights to use, to income or to transfer may last).

In what follows we review the nature of LE's claims on the scope and duration of rights of the final product emerging from production contracts.

i) Scope

On scope, LE's focus is on how contract terms may change and determine producer's use, income and transfer rights in relation to the ultimate product of screen, Film or TV production. The scope of use, income and transfer rights is determined along a number of dimensions. Thus as LE notes:

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"All the rights discussed .. may be broken down by specific identifiable markets. This might be done

- geographically and/or by other criteria, such as the
- platform over which they are delivered " (p14)

As LE notes this may cover so called "residual rights" or

"rights to distribute in small and unusual markets, such as

- *particular regions or formats; or*
- *merchandising rights" (p15)*

The scope of rights of use, income, and transfer, may further extend beyond any initial film or TV product to include as LE notes the:

"rights to create

- sequels and
- other derivative products

based around an initial film or series concept." (p15)

As LE notes:

"the script, characters, format, and name of a show may form the basis for future screen or other products:

- additional products in the same medium (such as movie sequels or additional seasons following an initial TV series), or
- spinoffs in a different medium (such as a TV series based on a movie)" (p14)

As LE further notes however

"The parties to an initial production agreement may agree on who has the right to

- initiate these future exercises, and
- what participation (financial or operational) other parties might have if future products are created" (p14)

The scope of all rights in screen, film or TV products may thus be allocated by contract. Complex rights structures may thus emerge by contract, including what LE describes as last matching rights, which are rights to control how any rights can be transferred to third parties, entitling the holder of last matching rights to acquire a right on the same terms offered by a third party.

In section 2c) LE claims the problem with the scope of contract rights in Australia however is that

- *"Too many rights may be in funders' hands – Particularly in a small market such as Australia" and*
- *"global streamers may not be best placed to develop particular series and franchises"… "With the global streamer not having the skills or the management bandwidth to nurture the value of Australian content into a long life"….*
- *"Yet their negotiating power may well mean that they retain the important rights controlling such matters." And*

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- *"there may be more stranded IP than would occur if producers retained these rights"*

These claimed outcomes from contracting in a competitive market are highly speculative, and not clearly derived or supported by evidence. There are a number of problems with LE's claims.

First, LE assumes that streaming companies do not have the skills or the management bandwidth to nurture the value of Australian content compared to producers. Thus, the retention of rights by streaming companies is not in the interest of Australian welfare. This conflicts with LE's own description of most producers as very small operators e.g.:

> "most industry participants are SMEs, typically with no more than a handful of permanent staff." (p10)
>
> "the industry….most salient structural feature is that content producers are mostly small" (p16)

On the contrary it appears more likely that compared to the global streaming companies, on average Australian producers may not have the skills or bandwidth to fully exploit global rights for Australian content. Reflecting on the same situation in Canada, the Canadian Radio-television and Telecommunications Commission (CRTC) in 2015 revoked its 2006 decision to encourage, and impose terms of trade agreements between broadcasters and producers, similar to those in the UK overseen by Ofcom. The most significant reason for CRTC's decision to no longer encourage or impose terms of trade agreements was that despite having imposed the UK-style terms of trade regulation in Canada, most independent producers in Canada remained very small or temporary in nature (like Australia). They therefore lacked the capacity to support long-term exploitation and export of content. While broadcasters had greater capacity, CRTC noted they did not have an incentive to promote the long-term exploitation and export of programs, since the international rights were often held by producers *under terms of trade agreements* enforced by CRTC, as recommended by LE for Australia. The CRTC thus decided that

> 141. In the Commission's view, it is no longer necessary for the Commission to intervene in this relationship by requiring adherence to terms of trade agreements [39]

Second, LE's claim that the scope of rights acquired by streaming companies is too wide, and that rights remain stranded as a result, rests once again on LE's assumption that streaming companies have greater bargaining power, which they then abuse to negotiate rights they are not best to manage, and the rights become stranded as a result. We have already however refuted LE's notion that streaming companies have market power, and that they are not best able to manage the rights. Even if streaming companies had *bargaining power,* however, it would not be rational for them to unreasonably restrict access to the rights. It would be in their interest to sell the rights to those that value them more rather than leave them stranded in the circumstances outlined by LE. If there was someone better able to manage rights, then a rational current owner of the rights, even with bargaining power, would be happy to sell them, so long as the buyer met both the

[39] See Paragraph 141 of the 2015 CRTC decision here: https://crtc.gc.ca/eng/archive/2015/2015-86.htm

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current owner's direct costs of transferring the rights (transaction costs), and their opportunity costs (namely the lower profit the current owner could make from the rights).[40]

Finally, just because rights are unused does not mean they are stranded in a way that is bad for Australian welfare. It may be that the benefits of use do not exceed the costs from their use, or that there is no alternative use. There may thus be no users that could create net value and increase Australian welfare from the rights given the direct costs and opportunity costs of their transfer and use. Given the phrase "stranded" rights connotes a bad outcome, stranded should only be applied to rights that remain unused when there are net beneficial alternative uses, or users that could create net value from them, having regard to the costs of current owners of the rights, and the costs of exchange. Thus it may be efficient, or in the interest of Australian welfare for rights to remain unused sometimes - they are not "stranded" in a bad sense, they are efficiently disused.

ii) Duration

All the elements of rights (to use, income and transfer) whatever their scope can also be varied by their duration through contract. As LE notes, duration terms determine

> "the length of time over which the funders acquire the content over some period deemed necessary to generate a satisfactory reward for their investment in funding the production p14

Later noting further that

> Such rights include rights to the 'long tail' of a product over time—say, rights after seven years of screening p15

In section 2 c) LE claims the problem with the duration of rights in Australia is that

> Licensing periods may be too long. Before the structural transformations brought on by streamers, FTA buyers of content tended to seek licences of around three years, with IP rights retained by the producers who can sell licenses (for the program or the format) into other markets or develop other IP rights (e.g. historically video and DVD distribution and occasionally merchandise). Today, where they do not seek rights in perpetuity, streamers seek at least seven years and typically 10 to 15 years of exclusive SVOD rights, though we also heard of a few shorter licence periods. (p25)

Generally then LE claims the licensing period, or duration of time that rights are being transferred for is increasing. Thus LE suggests that FTA buyers of content in Australia tended to seek licenses of only around three years for the local market (presumably for Australian rights only,

[40] A recent example of this open approach to licensing content is Warner Bros recent decision to make more of it's films available to others under non-exclusive deals, including the Lord of the Rings, and Hobbit films that it had previously locked up exclusively for streaming on HBO Max. The trilogy generated nearly $3 billion in box office revenue and comprises some of Warner's best-known film IP. Warner Bros has been one of the most aggressive about selling shows to other networks and platforms, but has become even more "open to business" than before. See https://www.hollywoodreporter.com/business/business-news/david-zaslavs-strategy-shift-licensing-out-warners-ip-treasure-1235222408/

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given these FTA commissioners operated in Australia only), leaving other IP rights to producers. What LE fails to acknowledge is that many of these shows have been co-funded for many years before streaming companies even existed with foreign investors who have taken out long-term licenses. By comparison, LE claims streaming companies, (who seek global rights and are then able to fund the show at a higher level commensurate with those global rights) seek licensing periods of at least seven years, and typically 10 to 15 years for exclusive SVOD rights - where they do not seek rights in perpetuity – though LE also heard of a few shorter license periods. LE suggests this is new behaviour, but in fact it has been prevalent for many of the international rights.

LE claims these longer licensing periods acquired by streaming companies arise from the abuse of market power by streaming companies as commissioners or buyers of content, and are not optimal. As we have shown, however, the market is competitive, market shares are low, there are no barriers to entry and cartels would be hard to sustain. LE's prediction that duration of terms are too long due to an abuse of market power is thus based on a flawed theory that is refuted by the evidence discussed earlier.

LE then does not explore, let alone explain, why the duration and scope (i.e. geographic and other) of the rights transferred by producers are being increased *in parallel* through the streaming companies' agreements. The extensions to the duration and scope of licensing terms over time claimed by LE, could simply be a result from a more competitive market, and therefore likely to have a legitimate, more efficient, market-based, or rational business explanations. If a funder or buyer of content like a streamer could not secure all rights under a licensing agreement from the creator then, in those markets, or during those time periods that they are not licensed for, they would face the prospect of competition from copies or versions that would be released by the creator, or producer, after the creator or producer had been funded or paid to create or produce the goods. The creator or producer who competes with their major funder or a major buyer of content in the same market would not bear the creation or production costs the funder or buyer had paid them for anymore, and could therefore offer a lower average price to consumers, cannibalising the licensed funder or buyers' market share.

This risk to funders and buyers that arises after buying or funding content creation, and production has been exacerbated over time by the greater ease today of digital copying and distribution of films through increasingly ubiquitous high speed broadband internet. Funders and buyers, aware of this greater risk over time, would therefore require more extensive rights over time to protect their investment than they did in the past, (playing "catch up" with the advances in technology), but their investment today would increase with the increased extent of those rights granted compared to the alternative, which would be good for producers over time, and Australian consumers.

Streaming companies' supposed demand for longer licensing periods and wider coverage, as claimed by LE – especially when paired with higher production budgets – thus seems likely to be efficient. Large streaming companies would need the longer duration and wider scope to justify their greater investment not only in the show itself, but also in technology and worldwide distribution and marketing. A key factor could be the higher budgets made available by streaming companies that can only be justified on the basis of global rights as the investment cannot be recouped through Australian audiences only. In exchange for extended licensing terms or a broader scope, a global streaming company would likely be best placed to make higher investments in production, based on its global distribution platform and the information it alone

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can glean from the profile of viewers watching globally. In exchange for the longer duration and wider scope, the producer could thus be offered (and accepts) a higher probability of success – albeit for a lower potential upside. At the same time, Australian consumers would benefit as through the extended licensing terms, a streamer could make higher cost/higher production projects available to Australian consumers at a lower price, off the back of the greater revenues it could recover from global audiences interested in those programs. This way of contracting, involving extended duration and scope of terms, would likely be more efficient for streaming companies, producers and Australian consumers.

5.2.3. Rights over Preparatory Content or Development work

As noted LE's fifth and sixth contract term categories both relate to the initial stage of production involving preparatory content or development work and involve two types of alleged conduct:

- Rights mitigating competitive threats to the funder. (LE's Category 5)
- (Defacto) rights to behave unreasonably. (LE's Category 6)

I address each in turn:

i) Rights mitigating competitive threats to the funder.

As noted LE's fifth concern arises when preparatory content or development work is halted and further exploitation ceases, leaving a developmental asset that can become stranded due to contracts that contain last matching rights, and as a result no further development occurs. LE raises the public policy concern that such contract terms may be too restrictive of competition, and impose costs on third parties as a result.

LE defines last matching rights in a footnote as follows.

> "Last matching rights enable their holder to insist that, if the party that has done the development can find another backer for further development, that the original funder of the development has a right to match the terms offered by the second potential funder." Page 16 footnote

LE claims that

> Placing excessive weight on their competitive position funders' rights strand content .. firms funding development and content require producers to give them rights, such as last matching rights, to protect their position against competitors. P25

LE claims that beyond a relatively short period of time to enable the original funder to decide if they wish to further develop the asset, last matching rights (LMR) speaks to an original funders own perceptions of their commercial interests, and desire not to give any advantage to their competitors. LE argues LMR are analogous to 'non-compete' clauses which give firms rights over employees leaving their employ for competitors, and poses a similar collective action problem, as although such clauses may benefit an original employer (funder), they leave the skills of employees, (and by analogy producers of development assets) less free "to circulate within the industry to find their highest value uses". By analogy LE is thus claiming that last matching rights

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would prevent producers' development rights being reassigned from a less efficient original funder, to a more efficient new third party funder.

LE provides no evidence, however, for this anti-competitive effect, beyond this simple assertion. We have already shown the market is competitive, market shares are low, there are no barriers to entry and cartels would be hard to sustain. The original funders thus do not have market power, and it would hard to see how they could impose overly-restrictive terms that are anti-competitive on the market. Thus, the reality is that a funder's desire not to give an advantage to their competitors would be likely to remain unfulfilled to the extent there are more efficient funders in the market than them. In a competitive market, there is no ability to prevent a more efficient firm from acquiring the right to further development through a last matching right. The reason is that a more efficient funder would always be able to pay more for development rights than a less-efficient original funder, and so the rights would always end up with the more efficient funder, subject to transaction costs. Thus, if there is a third party that is more efficient than the original funder, they will be able to fund the project, with sufficient money for the original funder's rights to be bought out. They could draw on the greater profit the more efficient third-party funder can make to compensate the original funder for the lower expected profit they would have been able to make, had the producer stayed with them. There is no scope for a funder to deny an advantage to their more efficient competitors, as the market is competitive, so the last matching clauses are not a threat to market competition.

Given the competitive nature of the market, last matching clauses are instead most likely to have an efficiency explanation, and be pro-competitive. They are more likely to entail more efficient contractual arrangements that make original producers and funders of a project more competitive, and more likely to invest in production – further enhancing competition. It is natural for the parties to agree a term in an original contract to cover the eventuality where a producer may want to try and find third parties willing to continue to fund a project, where the initial development has been put on hold. Such a term would lower transaction costs of later negotiations about a transfer to a new funder, at which later time the original parties are locked into a relationship, and bargaining can be more difficult or costly, or subject to hold up. Last matching rights thus in fact imply a situation where producers retain development rights, but on condition that if they intend to transfer to a third-party funder, then the original funder can instead require the producer to stay with them, or transfer their rights on the same terms. The producer may thus still retain the rights, and can continue to try and obtain a better deal with the third party or the original funder.

Last matching rights thus reduce transaction costs by avoiding a costly future breakdown in bargaining between a producer and the funder and by guarding against a sale to a less efficient third party. Last matching rights are thus likely to be efficient and promote the welfare of Australians. It is useful to delve deeper to make this clearer. As noted earlier one of the key determinants of transaction costs in a contractual relationship is the existence of relationship specific assets. These are assets that have value in the relationship but not outside of it. For example, a maker of components for Mercedes Benz may be in a competitive position before they win a supply contract (before the event or ex-ante), but then later (after the event or ex-post) they have to make investments in production that are specific to Mercedes' needs, and of no value to other firms, so they become locked in and exposed – and vice versa. The problem facing producers and funders or buyers of screen content is the same, that in the future they may find themselves in a long term relationship that depends on a relationship specific asset, which they need to preserve to maximise joint value.

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Initially at the start of a contractual relationship the parties are in a competitive situation, and there are no relationship specific assets so transactions costs can be kept low by the fact each party has outside options, or has competitors, and so are forced to more quickly and cheaply agree to deals that meet just their opportunity costs, and not be opportunistic, or bluff or lie about what they need, or hold up the process and haggle too much about how much burden they wish to bear or reward they require. Once terms are agreed however, and the parties start production and then ultimately release the content, their relationship may be transformed by the existence of relationship specific assets, or an asset that is worth more if they continue to co-operate together than if they each exit and switch to third parties. At that point transaction costs increase, as after the event (ex post) or after negotiating the original contract the parties face more of a bargaining range to haggle over, and the parties may dissipate value trying to secure a greater share of the relationship specific value for themselves, even to the point a transaction does not occur at all e.g. they do not complete a sequel and value is lost.

Last matching rights (or rights of first refusal) may enhance efficiency by reducing producer's incentives to engage in strategic search for certain third-party buyers, by improving funders incentives to take steps to increase the value of the property, and reducing the costs associated with strategic bargaining.[41] Last matching rights enable the price the original funder has to pay a producer *ex post* to be subject to a competitive market check. If the producer can find a third party in the market willing to make a sequel at a "market price", then the original funder by contract has indicated they may be willing to at least match that "market price". This reduces transaction costs. Of course if the external third party is able to create greater value than the original funder, the new deal will go ahead without the original funder, as any specific assets with the original funder do not add sufficient value. The external third party may quite simply be more efficient, or at least believe himself, or herself to be, and therefore willing to pay more than the original funder is able to offer.

The primary reason why last matching rights agreed at the outset reduce transaction costs later, then is that they limit scope for opportunism by producers seeking to achieve a better deal, after funders have made an initial sunk investment in an asset that producers now control, when there is no better market option for the producer. Last matching rights avoid a situation arising when after making a relationship specific sunk investment in development, and being "locked in", funders may be unable to effectively enforce the original terms of the contract against their producer, even when the open market will not support the producers opportunistic demands. Last matching rights by permitting a "market test" for the rights outside of the relationship, avoid a hold up situation, where a producer is asking for more than the market value of their rights, or

[41] See Kahan, Marcel, An Economic Analysis of Rights of First Refusal (June 1999). Available at SSRN: https://ssrn.com/abstract=11382 or http://dx.doi.org/10.2139/ssrn.11382. The right may also increase the joint profit of the seller and the right-holder by reducing the third party's profit – see Choi, Albert H., A Rent Extraction Theory of Right of First Refusal (September 2, 2007). Available at SSRN: https://ssrn.com/abstract=397460 or http://dx.doi.org/10.2139/ssrn.397460. The right may also promote efficiency by inhibiting the unilateral withdrawal of a party without further negotiation see Walker, David I., Rethinking Rights of First Refusal (August 1999). Harvard Law School, Discussion Paper No. 261, SSRN: https://ssrn.com/abstract=188190 or http://dx.doi.org/10.2139/ssrn.188190

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engaging in excessive search for third parties, and would as a result encourage greater investment in production in the first place (something LE fails to consider), while not preventing later transfer to more efficient funders. This is in the interest of all Australians.

Thus complex contractual structures in a competitive market like the producer market involving last matching rights and other terms around the transfer and use of derivative rights that may create what a producer sees as delays may in fact be efficient from the point of view of joint value creation, pro-competitive, and in the interests of all Australians.

ii) (De facto) rights to behave unreasonably. (LE's Category 6)

LE's sixth and final concern arises when funders have already agreed to terms, and development work on preparatory content has started, and then funders add further burdens onto producers who have already invested time and resources into the project. LE describes this behaviour as involving the use of "de facto rights" to behave unreasonably. The term "de facto rights" used by LE is usually distinguished from "de jure rights" in that de jure describes practices that are legally recognised. LE's reference to de facto rights thus seems to refer to rights that exist in reality but either: do not exist in contract law at all; or do exist legally, but are not legally enforceable. As we shall see LE is probably referring to the latter situation as LE notes the examples of de facto rights it cites may be covered by the law of unconscionable conduct, but "legal remedies are extremely expensive to access and, in any event, come with long delays between initiation and resolution". Thus the problem of concern is that an inability to legally enforce one's legal ("de jure") rights leaves one's contractual partner with "de facto" rights to behave as they wish.

LE refers to only three specific illustrations of "de facto" rights to behave unreasonably:

> "Examples of unreasonable behaviour can relate to:
> i. onerous payment schedules for financing,
> ii. production companies fully or largely bearing the risks for events outside of their control, and
> iii. productions effectively being forced to start before contracting is completed to meet deadlines. (p26)

In a competitive market however such abuse of "de facto rights" is often solved by self enforcement, or reciprocal de facto rights, including:

- the threat of "tit for tat" behaviour, and even
- competitive exit from the relationship, or contract termination.

The losses that such countervailing actions impose on any misbehaving party may often deter abuse of de facto rights. The problem of de facto rights in a competitive market can also be solved by more complete contracting *ex-ante* that establish explicit terms that compensate for and/or limit such behaviour – such as higher producer prices, strict financing schedules, transfer of the costs of risks beyond a producers control to commissioners, and strict start dates with advance payment bonds and/or penalties for breach. In a competitive market a producer will be able to shop around for such better terms that explicitly compensate for, and/or limit the risk of abuse of de facto rights. Thus the market itself solves the problem of risks associated with de facto rights, leaving only those de facto rights of minimal concern, (or for which transaction costs of further negotiations outweigh the benefits of more complete contracts) plus a "price"

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adjustment, or extra margin that compensates for any residual risk from de facto rights borne by producers.

LE further suggests all the above three listed unreasonable behaviours may also be covered by the law of unconscionable conduct, thus LE notes

> Unreasonable behaviour may also be unconscionable conduct at law. (p26)

Unconscionable conduct in law is a term used by courts to describe conduct that is either unjust or one sided to the benefit of one party more than another. In contract law an unconscionable contract, or contract term is so unfair or one-sided that no reasonable person would enter such a contract without a compelling reason. The law thus does not enforce what are likely to be inefficient terms from an economic perspective.

Thus according to LE, unconscionable conduct, contracts, and contract terms are governed by law, and the contracting party adversely affected by such conduct may be said to have a legal right, and a remedy to prevent it occurring. Producers thus already seem to have legal or "de jure" rights that would override the de facto rights LE claims are at stake here. The residual problem LE seems to be focusing on then is that

> *"**legal remedies are extremely expensive to access** and, in any event, come with long delays between initiation and resolution"*

The problem with LE's analysis of the consequences of the costs and delays of the legal system however is that it does not adequately analyse the nature of the world as it exists now, and fails to compare the outcomes LE is concerned with to feasible real world alternatives.

On the first point, of course the legal system is costly and involves delays. The costs of the legal system are however taxpayer-subsidised already. Court rules also provide that winners of court cases have their legal costs paid for by the losing side. Thus producers can recover their legal costs if they have a strong case they can win. Producers can also now obtain litigation funding for the costs of large valuable cases. Litigation funding can have the effect of enabling, and speeding up dispute settlement, as deep-pocketed defendants are deterred from using delay as a means to wear down or exhaust the finances of poorer plaintiffs. There are also class actions for cases that affect many producers, or have precedent value. Past case law developed over centuries has also established precedents on contract terms that current producers did not have to pay for – precedents like the unconscionable conduct rule, that deter illegal behaviour by buyers of content, and so minimise the problem highlighted by LE. There are also numerous low cost alternative dispute resolution mechanisms available. Thus the problems that LE cites of legal costs and delays are already addressed by a number of tailored interventions. This may nevertheless still leave funders with "de facto" rights to engage in behaviour that may seem unreasonable. One then has to look at the net benefits from societies point of view of further legal enforcement when evaluating such an outcome. Although further legal enforcement of rights may have residual benefits, it will also have costs. If costs of further legal enforcement activities exceed the benefits, then it is not in the interests of all Australians that further enforcement occur. The outcome with no legal enforcement may thus quite simply be efficient, or in the interests of all Australians. It would be inefficient to enforce producers' rights legally in a court of law, if the benefits of enforcement are lower than the costs, and there are better alternatives to legal enforcement, like

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"tit for tat", exit, more complete contracting *ex ante*, or dispute settlement based on the threat of litigation without the need for actual legal enforcement.

On the second point, one cannot criticise the legal system as costly with long delays by comparing it to a fictional "nirvana" system that is costless. One has to compare the legal system to real world alternatives that generate better outcomes. In this regard one needs to engage in comparative systems analysis – which LE does not do. One needs to compare the costs and delays of the legal system, to the costs of delays of the regulatory system, and the market for example – which LE does not do. As a result LE's problem definition and conclusions in this section are unfounded. The fact that "legal remedies are extremely expensive to access and, in any event, come with long delays between initiation and resolution" does not cause a policy relevant problem unless this is compared to a real world alternative that can offer greater net benefits at the margin. This is not established by LE. Indeed as we show in the remaining sections it seems clear that current market and legal arrangements, or the current system, is more likely to generate better outcomes for Australian welfare than the UK-style regulatory intervention recommended by LE.

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6. Current Market and Relevant Legal Context

Before turning to assess the nature and likely consequences of LE recommended UK-style regulation of terms of trade, it is important to first summarise the current factual situation in the relevant market and relevant existing law.

LE's recommendations, and the consequences of those recommendations, depend on the initial conditions both in the market and the law, and how LE recommendations will change those conditions, or change how the current market is currently regulated by existing relevant law.

As we shall make clear in this section the current market situation is not as LE describes it. Rather, it is very competitive, and there is no apparent imbalance or abuse of power by buyers of content as claimed by LE. Moreover, even if such conditions ever arose or existed in the market, current competition law in Australia would address the problem.

As we make clear, the risk then is that LE recommendations will undermine the operation of the current market and current legal arrangements, and have significant costs – which we describe in the next section.

6.1. Market competition

Our analysis presented above makes clear that market competition can be relied upon to ensure contract terms in the film and TV market are efficient, or in the interest of all Australians. Any attempt by a buyer to pay less than the market value for producers work would be met by competitors offering better deals, as the buy side of the film and production market is highly competitive for a number of reasons.

1. First there has been an improvement in competitive conditions on the buy side, with growth of within market competition or rivalry demonstrated by recent falls in market shares, or the degree of market concentration amongst buyers.

2. Second it is clear there are low barriers to entry to streaming on the buy-side, with many new entrants able to easily enter the market to compete with the incumbents. This is demonstrated by how FTA and pay TV firms have faced increasing new entrant competition, first from specialist streaming companies like Netflix and Stan (itself owned by one of the FTA networks)[42], but also from general online distributers including Amazon, a firm that started as an online bookseller, but has become fully diversified. More recently one has seen the entry and growth of other specialist online content distribution companies, including Disney+ and Paramount+.
3. Third, the scope for explicit or tacit collusion, or co-ordinated oligopolistic cartel action is highly limited by competition from new entrants and incumbent firms offering better terms.

[42] In fact, subscription television provider Foxtel together with FTA firm Seven tried to be early entrants as well through its failed service Presto.

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6.2. Current Law

In addition, LE fails to mention or acknowledge how current law limits the scope for any abuse of market power should it arrive or exist in the market in any event. As we outline below

1. First, one has the supervision offered by the ordinary courts using the common law restraint of trade doctrine.
2. Second, one has the discipline offered by supervision of the ACCC under the Consumer and Competition Act 2010 (CCA).

LE fails to recognise how this current law already adequately addresses the risk of market wide competition problems of the type that LE claims affect current terms of trade.

6.2.1. Common law restraint of trade doctrine

Under the common law restraint of trade doctrine, it is open to any producer to simply not comply with any contract terms that are overly restrictive of competition. Briefly, the doctrine renders provisions which impose restrictions on a person's freedom to engage in trade or employment illegal and therefore unenforceable at common law unless reasonable, both in the interests of the parties (onus on the party relying on the restraint) and in the interests of the public (onus shifts to person seeking to strike down restraint to demonstrate they are not reasonable in the interest of the public).

Under the common law a contractual undertaking not to trade is void and unenforceable against the promisor (in our case a producer) as contrary to the public policy of promoting trade, or competition. The courts are able to refuse to enforce all or part of the contract as being too restrictive. Thus the court could sever an overly restrictive duration term or geographic coverage term. The producer could thus disregard any overly restrictive term and then simply defend any attempt to enforce a restrictive term by a funder or distribution company.

In Australia the common law doctrine of restraint of trade continues to operate where it does not conflict with the *Competition and Consumer Act 2010* (section 4M). LE tends to discount these types of common law legal remedies however because of the costs of using the court system. But this claim is misleading as the costs of using the legal system facing private litigation have been reduced by three major legal rules LE does not mention.

1. First, if a producer wins their case, the losing party has to pay the producer’s legal costs - so this makes the problem of legal costs simply one of finance.

2. Second, the legalisation and development of litigation funding has made it easier to finance litigation costs.

3. Third, producers can also bring class actions against similar or generic terms in their contracts that are unreasonable restraints of trade, which means producers could share costs to establish precedents against unreasonable restrictions under the common law doctrine.

In any event, legal costs are real costs that would be mirrored in the regulatory system proposed by LE. Instead of being litigators incurring legal costs, LE’s regulatory change would simply turn

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firms into lobbyists of the proposed regulator and ministers, potentially without avoiding the costs of litigation, as regulatory decisions and rulings are always subject to judicial review by courts. As with the transaction costs of using a market, and the litigation costs of using the courts system, one has to also recognise the costs of using and relying on a regulatory system. LE does not however make the case that regulation would involve lower cost intervention than current arrangements.

6.2.2. Competition and Consumer Act 2010 and the ACCC

LE also fails to acknowledge that the Competition and Consumer Act 2010 (CCA) established the Australian Competition & Consumer Commission (ACCC), a taxpayer-funded agency that already independently supervises, responds to complaints, inquires into market problems, makes rulings, and prosecutes cases in court involving anti-competitive behaviour by film distributors, including unreasonable restraints of trade, price fixing, and cartel behaviour of distributors.

The taxpayer finances the ACCC to take cases all the way through the court system to the High Court, if necessary. This enables producers to avoid the costs of themselves establishing better terms of trade in courts and provides producers with considerable protection from anticompetitive behaviours.

Section 45 of the CCA thus prohibits contracts, arrangements, understandings, or concerted practices that have the purpose, effect, or likely effect of substantially lessening competition in a market, even if that conduct does not meet the stricter definitions of other anti-competitive conduct such as cartels. Section 45 thus covers the supervision of contracts and contract terms of the kind listed by LE.

The problem of oligopsony cited by LE is also addressed by the ACCC. Abuse of oligopsony market power if it exists requires collusion or cartel behaviour either tacit or explicit. Businesses that engage in cartel behaviours however and make agreements with their competitors to fix prices, rig bids, share markets or restrict outputs are prosecuted vigorously by the ACCC.[43]
The CCA not only prohibits cartels under civil law, but makes it a criminal offence for businesses and individuals to participate in a cartel. Individuals found guilty of cartel conduct could face criminal or civil penalties, and corporations could face fines or pecuniary penalties for each criminal cartel offence or civil contravention. t is illegal for a corporation to indemnify its officers against legal costs and any financial penalty. Other penalties for cartel civil contraventions or criminal offences include:

- injunctions
- orders disqualifying a person from managing corporations
- community service orders.

[43] Relevant sections on cartels in section 45 include: s. 45AA – simplified outline of the criminal offences and civil prohibitions relating to cartel conduct; s. 45AF – criminal offence for making a contract, arrangement or understanding containing a cartel provisions; s. 45AG – criminal offence for giving effect to a contract, arrangement or understanding containing a cartel provision; s. 45AJ – civil prohibition for making a contract, arrangement or understanding containing a cartel provisions; s. 45AK – civil prohibition for giving effect to a contract, arrangement or understanding containing a cartel provision.

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Producers and SPA have not yet even explored existing legal and private mechanisms to address any perceived problems LE identifies, including producer mergers to grow scale, or producers forming an association (like SPA) to engage in collective bargaining with distributors over terms of trade.[44]

6.2.3. Alleged Australian Precedent for the UK Style Regime

LE claims there may be precedents for the terms of trade regulatory regime in Australia, suggesting

> "Australia has similar arrangements
> - for providing access to national infrastructure under the National Competition Policy
> - and the News Media and Digital Platforms Mandatory Bargaining Code introduced in 2021 is another relevant example" (Page 35-36).

These interventions clearly do not however provide precedents for the proposed terms of trade regime at all.

The National Competition Policy (NCP) regime has to be distinguished for a number of reasons. First it was designed to overcome *legal* barriers to entry and greater competition, unlike the terms of trade regime that LE proposes. Thus, the NCP was introduced in the 1990s to introduce competition into areas of the economy sheltered from competition as a result of constitutional limits on the application of the Federal Trade Practices Act (now the CCA) or of other actions by Federal or state governments. It had important implications for the activities of state-owned enterprises, many of which had begun entering into commercial activities and certain exempt infrastructure entities. As we have seen by comparison there are no barriers to entry to the content production market, let alone substantial *legal* ones. Second, the NCP access regime only applied to firms that met a specified set of criteria, one of which was whether the firm had a natural monopoly in a market or could service a whole market most efficiently. This is not relevant to the content production market, which does not even involve an oligopsony (despite LE's claims), let alone a natural monopoly. Third, under the NCP access regime there was a so called "declaration process" during which it was decided whether the access regime applied. This is not the same as the terms of trade regime that LE proposes would apply to all content buyers by law automatically.

Similarly the News Media and Digital Platforms Mandatory Bargaining Code, which focuses on online news content, is quite different from the proposed terms of trade intervention and does not offer a useful precedent. First, it arose from the ACCC's existing powers to conduct inquiries under the Competition and Consumer Act (subsection 95H(1)). Second, like the NCP access regime, it involves a preliminary "designation" step, during which the Treasurer must decide

[44] The CCA however enables the ACCC to grant businesses an exemption providing protection from legal action under the Competition and Consumer Act when such conduct results in benefits to the public. Thus using such an exemption, producers could collectively bargain to establish terms of trade on price, etc. so long as they can prove to the ACCC that such conduct results in benefits to the public and does not involve offsetting cartel action, or costs.

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whether to designate a digital platform as subject to the obligations under the code (and no digital platforms have yet been designated). The UK terms of trade regime does not involve this first threshold step, limiting regulatory creep. Third, the first criterion for designation reflects the finding in the Final Report of the ACCC's Digital Platforms Inquiry that Google and Facebook (Meta) each had *substantial* bargaining power in their dealings with news businesses in Australia. As I have already shown, this does not apply to the relationship between producers and content buyers, which does not even involve an oligopsony, despite claims by LE. The News Media and Digital Platforms Mandatory Bargaining Code thus applies to two of the most powerful digital firms in the world - Google and Meta. The situation of Google and Meta is clearly incomparable to the situation of the streaming companies. For example, by way of comparison, Netflix's global revenues are around 30 billion while Google's revenues are over 250 billion. Finally, it is not clear how enduring the News Media and Digital Platforms Mandatory Bargaining Code will be, or how well it works. The code only came into effect on 2 March 2021, and as noted no digital platforms have yet been designated. Moreover, not long after the law's introduction on 28 February 2022, the Treasurer released terms of reference for the review of the Digital Platforms Mandatory Bargaining Code. A consultation paper was released to inform the review, with consultation closing on 6 May 2022. LE makes no reference to the analysis presented in the ACCC Inquiry report or in the recent consultation paper and submissions when it claims the Digital Platforms Mandatory Bargaining Code forms a precedent for the terms of reference proposal. If LE had, it would have been clear that the News Media and Digital Platforms Mandatory Bargaining Code is not relevant.

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7. The Nature and Consequences of the UK Regulation Proposed by LE

7.1. The nature of the UK Style regulation proposed by LE

LE recommends "Australia develop a UK-style terms of trade regime, to be overseen by the preeminent economic regulator, the Australian Competition and Consumer Commission (ACCC)." (see Page 2) The UK terms-of-trade requirement is established in section 285 of the UK Communications Act 2003 (UKCA). Section 285 (1) of the UKCA establishes "The regulatory regime for every licensed public service channel" that "will apply when agreeing terms for the commissioning of independent productions." Under the agreement between the UK Government and the BBC ("the BBC Agreement" or "BA") Ofcom regulates the BBC's commissioning of independent productions in the same way as section 285 regulates licensed Public Service Broadcasters (PSB). Ofcom also regulates the activity of S4C when commissioning independent productions in the same way as section 285.[45] Thus references to UK regulation under section 285 by LE are taken to include the BBC and S4C.

A key point then is that the UK regulatory regime applies to only licensed Public Service Broadcasters, the BBC and S4C. It does not apply to streaming companies. It also only covers the terms of trade for the commissioning of independent productions. LE proposes two extensions to the UK scheme as follows:

- "Though the UK arrangements apply only to the major FTA broadcasters, there is no reason why a similar approach could not be adapted to the market for streaming content." Page 35-36

- "As discussed in section 3.1, the 'terms of trade regime' we have sketched above would ideally be accompanied by some scheme underpinning demand—which would include local content requirements and tax offsets for local production." (Page 36)

LE claims

> "the UK legislation requires that buyers and screen production companies agree on terms of trade that preserve reasonable opportunities for screen producers, with oversight provided by a government regulator—in the UK's case, Ofcom." (Page 2)

Thus LE claims

> "The model used in the UK provides that standard minimum terms be developed by broadcasters with an industry representative body. What seems promising about this model is that it builds in scope for standard terms to be commercially negotiated by each broadcaster, subject to arbitration in the event that an agreement cannot be reached." (Page 35-36).

[45] a Welsh language free-to-air television channel, launched on 1 November 1982) (see Paragraph 10 of Part 2 of Schedule 12 to the UKCA).

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According to LE

> "in the UK, the communications regulator Ofcom seeks to influence the terms by requiring that public service broadcasters, which include both the BBC and commercial channels, negotiate standard terms of trade with the industry, as represented by the industry peak body PACT." (page 31)

Essentially then, it is clear that LE is proposing a collective bargaining model between

- Current licensed public service providers, government funded and controlled ABC and SBS, commercial broadcasters and subscription television and streaming companies
- A coalition of producers represented by an industry peak body like PACT, involving presumably SPA.

In essence this involves the unnecessary carte blanche legalisation and facilitation of cartel co-ordination on both sides of the market. As we shall see in the next section this will have significant adverse consequences for the welfare of Australians.

7.2. Likely Consequences of LE Proposed Reform

In what follows I first consider the benefits and the costs of the proposed UK style regulation arrangement in Australia, then provide a summary of the likely economic consequences.

7.2.1. Benefits

Given the highly competitive nature of the current market outlined in section 3 and 4 and summarised in section 6.1 above, and the existing legal and regulatory approach just outlined in section 6.2, the UK style regulation proposed by LE is unlikely to offer any marginal benefits for Australian welfare, other than perhaps in relation to the state-funded and licensed public broadcasters that may enjoy some market power. Even there however, the PSBs, like any corporation, are already regulated by the ACCC under the CCA. Moreover, the extent of the problem (if any) that exists with PSBs will have declined with the entry and growth of streaming companies in the Australian market. It seems likely that there will in fact be no benefits from the intervention. It is not likely to improve on the ACCC current role, but instead will extend, distort and complicate the ACCC's role in the economy. There may be costs to the market being regulated and to other markets, which now become less well regulated by the ACCC.

In any event any benefits from the intervention have to be offset first against costs to see if there are net benefits. In what follows we address the manifold and significant costs of the proposed intervention.

7.2.2. Costs

The costs of the proposed arrangements are numerous. I shall discuss them under three categories.

1. Cartel Costs and Risks
2. Collective Bargaining Transaction Costs and

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3. Regulatory Costs.

7.2.2.1. Cartel Costs and Risks

Compared to the existing more competitive approach to regulation in Australia outlined in the last section, UK-style regulation requiring collective bargaining will have considerable adverse effects on competition, and the welfare of Australians, by in effect supporting cartelisation of both sides of the market. The UK law will require buyers to bargain collectively with suppliers in the producer rights market, thereby enabling co-ordination between both buyers and sellers in a key input market that would not be permitted otherwise. One would see both buyers and sellers able or indeed required to meet and share information and co-ordinate on terms of trade. In effect the law would legalise a cartel on the supplier side of the producer rights market, and facilitate one on the buyer side, and support their joint co-ordination. This will create what might be called a legal anticompetitive cartel or "unholy alliance" between sellers and buyers, or incumbent producer and commissioning firms, enabling payments received by *both,* and prices paid by consumers to increase, while quantity, quality, investment, innovation and employment in the industry all fall.

By requiring legalised co-ordination between cartels on both the buyer and supplier side of the producer rights market that would not be permitted otherwise, the LE-recommended UK-style regulatory arrangement will enable incumbent buyers and sellers to "raise their rivals costs" and protect themselves from new entrants. This would create adverse conditions for competition in a key input market, and for new entrants seeking to break into that market. The UK-style collective bargaining regulation requires blanket coverage of the cartel agreement on terms of trade for all producer agreements. Essentially, new entrants on the buy-side would have to meet the higher cost of more generous terms of trade, including higher prices negotiated by the cartels as a consequence of the institutionalised collective bargaining. This would benefit the incumbent cartel firms by raising their potential rivals' costs. UK-style collective bargaining will enable incumbents to raise the costs of new entrants, and protect the incumbent members of the now legalised cartel from threat of new entrants competing on the basis of a cost advantage.

Evidence of this co-ordination in the UK can be found in statements made by the relevant parties. Two examples for illustrative purposes are the following.

1) In 2007 Ofcom issued a new statement about negotiations on terms of trade for new media rights noting "PSBs and producers have reached Heads of Agreement on terms for the exploitation of new media rights."[46] Although this process and outcome is being hailed by Ofcom as a good thing, what Ofcom's interpretation fails to recognise is the extent to which the process in fact involved coordinated action by incumbents in relation to adoption of new technology, legitimising what would otherwise be treated as cartel like behavior, on the mistaken presumption there would be no adverse consequences. This is naïve.

2) Similarly, in a recent 2022 Submission by PACT to APPG providing a Report of PACT negotiations with Channel 4 and BBC iPlayer, PACT described how "The Terms of Trade can react to technological developments and ensure that regular negotiations can happen between PSBs and indies to reflect changes in commissioning and consumption, evidenced

[46] https://www.ofcom.org.uk/consultations-and-statements/category-3/cop

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> by the deals we did with Channel 4 and BBC iPlayer over the last 18 months". Once again although this process and outcome is being hailed as a good thing, what it again fails to recognise is the extent to which it in fact involved coordinated action by incumbents in relation to new technology, legitimising what would otherwise be treated as cartel like behavior.[47]

The UK-style regulation will in effect support collective bargaining between legal anticompetitive cartels on both sides of the market in Australia, or what could be called an "unholy" alliance, allowing incumbent producer and commissioning firms to raise their rivals costs, and deter new entrants, by using the regulatory process to share information and co-ordinate their actions on the adoption and deployment of new technology – all with the help of Government. New entrants and competitors will have to match the regulated increased terms of trade for incumbent producer and commissioning firms, and conform to cumbersome technology rules over their main competitive threat - technological innovation. This will enable incumbents to increase their costs and pass them on to consumers without competitive threat, increasing the price paid for screen content by consumers and reducing quantity, quality and total employment in the industry. This would clearly harm Australian consumer welfare.

7.2.2.2. Collective Bargaining and Transaction Costs

It may be argued that such adverse outcomes would be overcome by producers and commissioning firms having incentives to avoid costs that may harm Australian welfare. This, however, ignores the effect of the regulation in increasing transaction costs. A competitive market is likely to provide incentives for parties to minimise transactions costs, and adopt the most efficient terms of trade. In a competitive market therefore arrangements like collective bargaining by parties over terms of trade might emerge, but if the terms of trade agreed were inefficient then the arrangements would be eliminated by competitors entry to the market adopting different terms of trade. Only the most efficient terms of trade would survive the competitive process. There would be low transaction costs between efficient and competitive firms and their consumers, unconstrained by bureaucratic, cumbersome regulatory processes on terms of trade in input markets overseen by a regulator.

There are large scale transaction costs that can lead to inefficient outcomes if a protected UK-style regulatory environment of the type proposed by LE were adopted in Australia. These include:

a) Producer Transaction costs. The UK regulatory structure requires internal collective agreements between producers themselves, for example by PACT members inter se, before terms of trade offered by the BBC can be accepted. This creates scope for a median voter problem, or tyranny of the majority where an outcome that benefits 51% percent of PACT members is adopted at the expense of the other 49%. This is problematic if a minority of producers produce most of the value, which seems likely, perhaps following the often asserted although perhaps apocryphal 20%/80% rule. In addition, typically members will have to appoint agents to negotiate on their behalf with the BCC or other commissioning firms. This will introduce principal-agent problems, where the negotiating team's interests are

[47] https://www.appgmedia.org/newsandviews/a-critical-moment-for-ip-independent-tv-producers-and-the-psbs

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not aligned to those of the producer members. This may result in less negotiating effort, playing one group of members off against another, or simply error as agents do not have the information to judge the member's best interests.

b) Distributor transaction costs. To the extent the proposed UK regulatory structure requires or supports implicit or explicit collective agreements or co-ordination between distributors on some or all of the terms they agree with producers, the same transaction cost outcomes emerge, such as the median voter problem, and principal agent problem.

Introducing regulated collective bargaining by a cartel of buyers and sellers will only impose one size fits all solutions, when more decentralised, dynamic, innovative and tailored arrangements likely to emerge from the already quite competitive market would be more efficient, and in the interest of Australians.

7.2.2.3. Regulatory Costs

It may alternatively be argued that any adverse outcomes or harm to Australian welfare would be overcome by the ACCC's oversight of the process of negotiations and the outcomes. This however ignores the effect of regulatory costs, regulatory failure and increasing transaction costs. There are a number of regulatory costs that are likely to arise with the LE proposal:

i. Regulatory Creep. The proposal in itself involves what is called regulatory creep where regulation slowly and in small steps moves to cover more markets or determine more terms of trade for more exchanges within markets than is efficient. This is a natural outcome, to the extent politicians can sell regulation to the public as a solution to problems when in fact it isn't, due to asymmetric information, or lack of transparency and the information costs, and dispersed nature of those affected by regulation. At the same time received economic theory of bureaucracy points to the incentives of regulatory agencies themselves to seek new regulatory remits, as it increases the budget of the bureau, and ultimately therefore the salaries, and non wage benefits including the status, power and support staff of the senior managers and executives at the regulatory agency.

ii. Regulatory Capture. Another cost of regulation is the likelihood of regulatory capture where the agency and its governing rules become captured by an interest group, where an interest group may be a group of firms that share the same self interest in securing a regulation that benefits them most. Regulatory capture can lead to regulation tilted toward the interests of the regulated parties, rather than protecting those the regulation is meant to benefit, as the regulated parties are in closer more regular contact with the regulator than dispersed affected parties. This may happen particularly where the benefits of the regulatory intervention are concentrated and the costs dispersed. In such cases, the interest group enjoying concentrated benefits will have incentives to lobby the regulatory agency strongly and "capture" or influence its decision-making. For the dispersed group adversely affected by the regulation they will find it hard to organise to lobby and oppose or make the case against regulation. With asymmetric costs and benefits, a regulation may proceed although greater total costs or harm is imposed on a dispersed but "silent " group by a regulation, while lower total benefits are concentrated on, and therefore supported by a particular active interest group.

iii. Regulatory error. Leaving aside the above incentive problems related to regulatory creep and regulatory capture, there are simple bounded rationality and information problems. Research

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in behavioural economics points to the existence of bias in decision-making involving heuristics or rules of thumb that may be means of economising on decision costs, and have origins in human evolution, but that can lead to systematic errors in modern contexts. Human beings don't change as they move from markets to regulatory environments, so this includes regulators who may adopt heuristics or rules of thumb that bias them to regulate, even when they should not. Information costs also can lead to regulatory errors where decisions are made based on poor information. This proses costs, risks and uncertainty on the regulated parties. They face regulatory uncertainty, and the likelihood of bias, or that the mean expected regulatory outcome is systematically not ideal, but also variance around that expected outcome. The probability of regulation and variance in costs of regulatory error pose risks that can be very costly. For example if the normal rate of profit in an industry is 10%, then what might seem like a small fall in prices, that may have significant political benefits for a regulator, or its political masters can reduce net profits a lot. For example, if costs are fixed in the short run, then a 1% fall in regulated prices would go straight to the bottom line and reduce profits potentially by 1 percentage point - or by 10% of the normal expected profit rate of 10% (i.e. 1%/10%). This considerable risk to profits would deter investment.

7.3. Summary of the Consequences Of LE's proposed reform

The foregoing high level cost-benefit or regulatory impact analysis highlights that the proposed LE scheme is very likely to be highly costly to Australian welfare, compared to the existing and more competitive approach to regulation in Australia outlined in the last section. Finally, it is useful to try and "salami slice" the above consequences of LE's proposed reforms and isolate the likely direction and relative scale of impact under different scenarios including the various extensions LE proposed, by considering three stylised options and compare each to current Australian law:

- The more limited actual coverage of the UK law – that is involving only PSBs;
- The further extension of the UK "style" schemes coverage to streaming companies as proposed by LE;
- The further linking of the extended UK style scheme to quotas, tax offsets, and related content policies as proposed by LE.

7.3.1. The Consequences if limited to the Core UK Coverage

Fiscal subsidies, government ownership guarantees and licensing controls can provide advantages to incumbents not available to new entrants and create clear barriers to entry by new players, distorting the market and weakening competition. As noted in section 4.2.2, it is clear the reason why UK law focuses only on PSBs and their digital channels is that these are the firms where the risk of market power is greatest, due to the protection or barriers to competition, including barriers to entry enjoyed by these firms. The greatest likelihood of market power arises with firms that benefit from Government subsidies, government ownership and licensing controls, and accordingly these are the firms that were regulated additionally by the UK law administered by Ofcom. For example, UK terms of trade regulation can be best understood to focus on the BBC in the UK, due to the subsidies the UK taxpayer pays the BBC and Channel Four Television Corporation due to the benefit of an implicit taxpayer guarantee it enjoys as a British state-owned media company headquartered in London.

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There seems to be no benefit from introducing the UK terms of trade arrangements given the ACCC already has the powers to regulate any abuse of market power by any PSB that may benefit from fiscal subsidies, government ownership guarantees and licensing controls in Australia. It is thus open for SPA to seek an authorisation to conduct collective bargaining from the ACCC (as it does in negotiations with the unions). Adding a new regulatory regime to the existing role of the ACCC in the same area, even if it may have marginal benefits, would add additional or marginal costs and risks. For example, creating a special regime poses the risks of potentially exempting the film and TV production rights market from existing law, by diverting them into an alternative regime, adding to the burden of both the ACCC and firms in the market, and complicating both administration of, and compliance with law. Thus the consequences of even a reform limited to coverage of government subsidised and/or owned and licensed PSBs are likely to be negative for the welfare Australians, and should be avoided.

7.3.2. The Consequences of Extension to Streaming companies

LE recommends the UK style regulatory regime be extended to streaming companies claiming that:

> Though the UK arrangements apply only to the major FTA broadcasters, there is *no reason* why a similar approach could not be adapted to the market for streaming content" page 36

There is however a clear reason to not extend the law to streaming companies, as it would have considerably worse consequences by reducing the level of competition in the market considerably. The full extent of the adverse consequences listed in section 7.2.2 would arise from this reform and this is the reason why it should not be undertaken. Compared to the existing more competitive approach to regulation in Australia outlined in section 6.2, UK style regulation requiring collective bargaining by streaming companies will have considerable adverse effects on competition, and the welfare of Australians, by in effect supporting cartelisation of both sides of the market, as well as by increasing transaction costs and by increasing regulatory costs.

7.3.3. The Consequences of Linking to Content Policies

LE identifies a number of policies that support Australian content in table 3.1 including (to quote)

1. **"Local content requirements -** ACMA imposes Australian local content requirements on FTA networks, although these were relaxed in 2020.
2. **Offsets (Producer, Location,** post/digi/vis**) -** Various tax incentives are provided by the Australian Government to encourage film and TV production in Australia…. potentially offset eligibility could be linked to contract terms.
3. **Incentives (location, state gov't)** State governments offer a range of "top up" incentives such as payroll tax waivers or direct subsidies to attract international co-productions to their state …potentially incentives could be linked to contract terms;
4. **Screen Australia Equity Investment -** In addition to administering the Producer Offset, Screen Australia has some funds and discretion to participate as an equity partner in co-productions.
1. **Public broadcaster procurement (ABC, SBS)** ABC and SBS are major buyers of content from Australian production companies" (LE Table 3.1 page 29)

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At several points LE claims that the UK-style regulatory regime, if introduced to Australia, should also be linked to content policies. However, it is not made clear how that would be done exactly. Thus LE vaguely mentions linking both Australian Government tax offsets and state government incentives to contract terms in table 3.1 above, similarly noting later

> As discussed in section 3.1, the 'terms of trade regime' we have sketched above would ideally be accompanied by *some* scheme underpinning demand—which would include local content requirements and tax offsets for local production. P36

LE also separately suggests terms of trade regulation could be linked to production quotas and offsets twice, but in each case focusing on the application of content quotas not only to FTAs but also streaming companies and using exactly the same words as follows:

> The terms of trade framework could also be linked to production quotas and tax offsets. For example, adhering to such terms could be made a precondition of eligibility for Australian content quotas imposed on FTA broadcasters and streaming services. (see page 5 and page 32)

LE indeed anticipates an extension of local content requirements to streaming companies claiming that:

> If a 20% (of locally-sourced revenue) quota is introduced, it would result in an increase in local screen production… a quota requirement for SVODs could boost spending on Australian content by $250 million per annum, meaning it could expand the existing $2½ billion industry by around 10% per annum.
>
> There is a legitimate public policy rationale for such a policy, given:
> - it would support the development of Australian culture which can be viewed, broadly speaking, as a public good; and
> - it would ensure more of the benefit from streaming companies entering the Australian market is retained in Australia (page 30)

Given the considerable costs outlined above from extending the terms of trade regime to streaming companies, however, it is clearly not a good idea to apply the terms of trade regime to them, even if they may have access to content policies like federal tax offsets and state incentives or content quotas. The cumulative effect of an investment obligation and terms of trade would exacerbate the risks significantly and increase the substantial likelihood of negative effects.

Similarly for PSBs and FTAs (i.e., non-streaming companies), the terms of trade regime should not be linked to content policies like federal and state incentives or content quotas for subsidised PSBs and FTAs. This would add costs but no benefits to the existing regime of ACCC oversight of abuse of market power under section 45 of the CCA. Thus the terms of trade intervention linked to content policies would not be a better policy option than relying on current law to limit any distortions to competition that may for example be created by content policies.

Given the costs and lack of benefits from the terms of trade regime, it should not of course be introduced at all, and linking it to content policies does not change that conclusion. Indeed applying terms of trade regulation to firms benefiting from content policies would just add to the

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distortions to competition created by content policies. Thus there is a strong body of economic evidence suggesting that contrary to LE suggestions quoted above content policies like content quotas

- Do not protect Australian culture so much as protect Australian production from competition.[48] Australian production thus becomes less efficient as a result of the weaker competitive pressure, and
- Overseas revenues therefore tend to fall over time, as less efficient Australian firms are less able to compete on a world stage. [49]

[48] Mas-Colell (1999) draws a useful distinction between "protection of national cultural production" and "protection of the production of national culture." Other economic papers show that a local content quota leads, perversely, to the increased internationalization of domestic content, or induces a shift away from international providers of those global genres towards domestic artists in the same foreign global genres. A quota that also requires increased broadcasting of "new" content yields an additional welfare loss but does nothing to incentives to sign up new producers.
Faddists, enthusiasts and Canadian divas: broadcasting quotas and the supply response (with S. Wilkie). *Review of International Economics* 23#2 (2015) 404-424.
[49] Frontier Economics analysis suggests protectionist policies reduce exports by 4.3%. See: https://anzsa.film/wp-content/uploads/2022/09/Frontier-The-Economic-Impact-of-VOD-in-Australia.pdf

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8. Conclusion

Compared to the current competitive market outcome and regulatory regime, I identify substantial costs and little to no benefits to the regime as proposed by LE. Essentially I show that LE is proposing *collective bargaining* between

- Current licensed public service providers, government funded and controlled ABC and SBS, and streaming companies, and
- A coalition of producers represented by an industry peak body, presumably SPA.

A key problem is that LE is very unclear about the objective of this proposed policy, and the problem it solves. My analysis reveals it is likely to harm competition and create significant harm to the welfare of Australians. Indeed, the objective of Australian competition law is to enhance the welfare of Australian consumers by promoting competition. LE's proposal to simply shift value between participants in the value chain for content does nothing to enhance the welfare of Australian consumers and is more likely to create harm.

LE poses multiple goals or objectives for its proposal, raising questions about which of its objectives takes primacy, and how to make trade-offs between them. I instead focus on the Government's more fundamental, overarching objective, namely, the promotion of the well being or welfare of Australians, contained in the Competition and Consumer Act 2010. I then assess LE's proposal against that objective using an economic cost-benefit framework. A key gap in LE's analysis that LE explicitly acknowledges is that its discussion paper is only concerned with the relationship between buyers and sellers of content, and fails to address the impact of its proposed UK style regulation on consumer welfare. This is a serious omission, as consumers will be considerably worse off under LE's proposal, weighing heavily against LE's recommendation.

The basis, or reason LE claims there is a need for intervention lies in an alleged key factual problem LE claims exists namely "the profound imbalance in market power between buyers and production companies." Contrary to LE's claim however I have shown that there is no "imbalance in market power between buyers and production companies". First I showed that LE's analysis forming the basis of the above claim is flawed. LE failed to accurately define the market before calculating market shares and concentration, adopting too narrow a market definition, which generated a high market concentration result. Given FTA and IPTV and pay TV services are no doubt part of the same market, market shares should be calculated for the combined market not separately as LE does. When one does this and analyses FTA and IPTV and pay TV services in one combined market, the level of the four firm market share or concentration is clearly very low, between 35% and 40% - much lower than the 70-80% cited by LE. Thus I showed that if one assumes the FTA and IPTV and pay TV services "market segments" are the same size (as they were in 2017-18)

- The four largest FTA broadcasters referred to by LE would on average have only 10% share each, and
- The four largest IPTV and pay TV players referred to by LE would on average have only 8.75% each, while
- Other firms combined would have 25% market share

This is not a very concentrated market on the buy side at all. It certainly does not reveal a "profound imbalance" as claimed by LE.

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A second reason why there is clearly not a profound imbalance of market power is that barriers to entry to the market are clearly low as shown by the recent entry of the streaming companies. The market is thus highly contestable. Even if there were high market shares, or high concentration, low barriers to entry limit any attempt to abuse market power, as such abuse will be disciplined by market entry, and loss of market share to new entrants. LE does not identify or assess barriers to entry. A second reason why there is unlikely to be abuse of any imbalance of market power is that it would require cartel or collusive behaviors, which would be hard to sustain in the current market, given the incentives for cartel participants to compete and cheat on any tacit or explicit cartel agreement and capture market share off other cartel participants. LE has provided no evidence of the existence of cartel or collusive behaviors.

Despite the absence of any reason to be concerned with a profound imbalance of market power I nevertheless reviewed the contract terms described by LE as evidence of abuse of market power. LE alleges the following three types of abuse of market power or anticompetitive behaviours can be found in the terms agreed in contracts between producers as sellers and buyers of content;

4) Prices have fallen, so that Australian screen producers income falls
5) Scope of the rights transferred to buyers by contract has widened to cover distribution worldwide and for sequels
6) Duration of the rights transferred to buyers by contract has increased, from 2 to 4 year to 7 and 10 and even to in perpetuity.

LE however fails to clearly establish that these contractual outcomes have actually occurred. More importantly it also fails to refute the alternative explanations for them namely that the new terms result from legitimate or efficient competitive market arrangements. On price falls for example, I conclude that if they exist, then they are most likely due to the more competitive market putting pressures on costs, or prices paid to producers, and this is good for consumers. On the second two alleged problems, contract scope widening, and duration increases, again these are likely to be efficient as the large streaming companies need broad scope and long duration to justify the higher investment in the projects they fund, as well as in technology and in worldwide distribution. More efficient terms on scope and duration would also benefit consumers. Regulation that threatens to alter such terms would be damaging to consumers.

I also showed that LE fails to consider whether the current law adequately deals with any of the problems or risks with contract terms alleged by LE. I showed that current law clearly already addresses the problems raised by LE. For example section 45 of the CAA is directly applicable, and it is administered by ACCC, the body LE recommends should administer the new law LE proposes. Thus any abuse of market power by content buyers leading to contract terms that substantially restrain competition, and are not in the interest of Australians, can already be reviewed by the ACCC, and made unenforceable. Adding a new regulatory regime to the existing role of the ACCC in the same area, for the same reasons, even if it may have marginal benefits, would add additional or marginal costs, and risks, for little benefit. As I showed for example, creating a special regime poses the risks of potentially exempting the film and TV production rights market from existing law, adding to the burden of both the ACCC and firms in the market, and complicating both the administration of, and compliance with law.

My focus then turned to look at the marginal effect of the proposed UK law, compared to the current competitive market outcome and regulatory regime. I identified substantial costs and little to no benefits to the regime as proposed by LE. In essence I showed the proposed *collective*

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bargaining under the law involves the unnecessary legalisation and facilitation of cartel co-ordination on both sides of the market. It will enable buyers and sellers on the two sides of the market to share information and co-ordinate (in effect form an "unholy alliance") and put up *both* of their prices, passing the price rises through to the end consumer, while reducing output and quality, further harming consumers. The regime will also add significantly to market transaction costs and regulatory costs, creating inefficiencies. As I showed this will have significant adverse consequences for the welfare of Australians. My high-level cost benefit, or regulatory impact analysis highlights that the proposed LE scheme is thus very likely to be highly costly to the welfare of Australians.

In short, the exact opposite to that predicted by LE will occur. LE's recommendations should not be followed. Instead reliance should be placed on the now highly competitive market and current law to deliver better outcomes for Australians.

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9. Glossary of Terms

ABC	Australian Broadcasting Corporation
ACCC	Australian Competition and Consumer Commission
AFTVP industry	Australian Film and TV Production industry
BBC	British Broadcasting Corporation
CAA	Competition and Consumer Act 2010
CRTC	Canadian Radio-television and Telecommunications Commission
FTA	free-to-air
IPTV	Internet-based Protocol Television
LE	Lateral Economics
LE Report	A discussion paper by Lateral Economics and commissioned by the Screen Producers Association entitled “Taking Australian stories and skills to the world in the age of global streaming”.
NCP	National Competition Policy
Ofcom	The UK Office of Communications, the UK’s communications regulator
PSB	Public Service Broadcasters
S4C	A Welsh free-to-air public broadcast television channel
SBS	Special Broadcasting Service
SNIP	small non-transitory increase in price
SPA	Screen Producers Association
UKCA	UK Communications Act 2003

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About the Author

George Barker is an expert in economic analysis of law and regulation. Currently an Honorary Associate Professor at the Australian National University (ANU), a member of Wolfson College, University of Oxford, and a Director of LECA. He has taught regulatory economics to staff of Australian regulators and regulated firms, conducted public good research and given expert economic advice and testimony on a wide range of matters relating to regulation of the information and communications technology industry, (e.g. regulation of the internet, spectrum allocation and use, carriers, and carriage services, and network access), and utility industries (e.g. energy, and transport), as well as competition law, intellectual property, contract, and tax law affecting a wide variety of other industries in Australia, Asia Pacific, North America, and Europe. Dr Barker has contributed to numerous competition and regulatory policy reviews in Australia, the Asia Pacific, North America and Europe. Dr Barker has given expert testimony globally before regulatory agencies, and before courts reviewing regulatory decisions on appeal - as well in arbitration cases in the Hague - and before Ministers and Parliaments engaged in inquiries, and reform processes in Australia, the UK, EU, New Zealand, China, Korea, Japan, and the Philippines. He has for example given expert testimony to US Federal Courts, the Federal Court of Australia, the High Court of New Zealand and his analysis through LECA has been cited in the UK House of Lords, by the High Court of England and Wales and by the European Commission. He was Director of the Centre for Law and Economics at Australian National University from 1997-2017 and was awarded the Olin Fellowship in Law and Economics at Cornell University USA in 2000, and has been a Visiting Fellow at the London School of Economics (LSE) (2015-2018), the Centre for Law and Economics at University College London (2010-2015), Oxford University (2008,) and at the British Institute of International and Comparative Law (BIICL) (2009-present). He was Chief Analyst and Economic Advisor at the NZ Treasury (1984 -1997). He is founding member of the Editorial Board of the European Journal of Law and Economics. He gained a DPhil in Economics from Oxford University in 1992, and holds a Master of Economics (Hons) and a Bachelor of Laws.

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