

Media Convergence Conference

Developing a regulatory framework for the new digital era

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It is clear that the media industry and the broad telecommunications industry are experiencing major structural and technological change. What were previously considered to be separate and unrelated industries are now being examined in the context of this relatively new model described as convergence. Convergence appears to have different meanings to different people. Its impact is likely to be felt in a large number of service industries. It will require new legislative structures and will impact on the agencies that regulate the industries. From the perspective of one regulator, the Australian Competition and Consumer Commission (ACCC), convergence provides opportunities for a new competitive environment and perhaps, ultimately, the removal of industry specific regulation and its replacement by the general competition law applied equally to all industries.

Convergence takes many forms but two related forms are of particular relevance to a competition authority: technical convergence and market convergence.

Technical convergence

Technical convergence has been largely brought about by digitalisation of the transmission of communications services. It has enabled different types of services to be transmitted over the same delivery medium.

But digitalisation by itself would be of limited use unless there was an agreed-upon format for controlling digital communications and conveying them to the intended addressee or receiving device. A set of protocols known as the Transmission Control Protocol/Internet Protocol ('TCP/IP') protocol suite fulfils this critical function.

As the Chief Executive of Telstra, Mr Ziggy Switkowski, has said:
...we will reach the point where virtually all communications products will be governed by the Internet protocol, where everything that moves will be digital signals, where voice communications are but a small part of a broader portfolio of digitised services...

Market convergence

Closely related to technical convergence is market convergence. Digitalisation is blurring the old market boundaries. As the Productivity Commission noted in its Report on Broadcasting:

With advances in digital technology, broadcasting, telecommunications and the Internet are converging rapidly. They are being fundamentally redefined in terms of

what they are, who provides services, and how they are produced and delivered. Broadcasting is becoming more interactive; it is not what it was when the Broadcasting Services Act was introduced in 1992. In this sense, convergence means 'change' rather than a literal 'joining together'.

Convergence is structural in nature

Technical convergence is creating new market dynamics and changing the structure of traditional broadcasting and telecommunications industries.

Indeed, the final report of the Convergence Review, which was recently tabled in Parliament on 10 May defines convergence as services sector restructuring enabled by digitalisation.

The definition was designed to capture the fact that changes to industry structure are the most profound changes associated with convergence. In other words, convergence is structural in nature.

From this perspective, the Convergence Review sees convergence as the transition between two structural models for service delivery:

- the traditional analog model using delivery means capable of delivering only the one service and which are usually vertically integrated with the supplier of the service in question; to
- the new digital model using delivery means capable of delivering many services and which are usually structurally separated from the service suppliers.

The Review argues that vertical structural separation in the new digital delivery model will be accompanied by new competition in industries which were previously monopolies or oligopolies, resulting in a services sector which is more fragmented and competitive. This, it argues, will require changes to the current strategies of regulatory authorities.

Let me focus on the fundamentals of competition law and policy and then outline what I see as some relevant enforcement strategies for the competition regulator, the ACCC, in this structural process of convergence.

The philosophy of competition

The ACCC does not promote competition for the sake of it. There is bi-partisan political support for the proposition that competitive markets can enhance economic performance for the ultimate welfare of consumers in terms of lower prices, higher quality and greater choice.

At the end of the day, it is all about enhancing consumer welfare. Competition produces four distinct benefits that enhance consumer welfare:

- it shifts resources to the production of those products and services more highly valued by consumers (allocative efficiency);

- it encourages firms to adopt less costly and more technically efficient means of production (productive efficiency);
- it encourages new investment and product innovation over time (dynamic efficiency); and
- it promotes equity through constraining monopoly profits.

The Trade Practices Act was enacted in 1974 in recognition of the importance of competition for consumer welfare. Indeed, the Act's statutory aim is to enhance the welfare of Australians through the promotion of competition and fair trading (s.2).

In its aim of promoting competition, Part IV of the Act prohibits a range of anti-competitive practices including anti-competitive agreements (s.45), misuse of market power (s.46), some exclusive dealing (s.47) and anti-competitive mergers (s.50).

Telecommunications specific competition regulation

An important feature of the Trade Practices Act is that, as far as possible, it applies uniformly to all sectors of the economy.

However, given the still developing state of competition in telecommunications, the uniform competition provisions in Part IV of the Trade Practices Act were supplemented in July 1997 by telecommunications specific regimes for dealing with anti-competitive conduct by carriers and carriage service providers (Part XIB) and access to carriage services (Part XIC).

As noted by the Minister for Communications in the Second Reading Speech at the time:

Telstra continues to wield significant market power derived primarily from its historical monopoly position. There is also scope for incumbent operators generally to engage in anti-competitive conduct because competitors in downstream markets depend on access to the carriage services controlled by them.

The ACCC saw that its job was to ensure that competition in the Australian telecommunications market was established and protected.

We helped establish competition by declaring access to specific network services under Part XIC of the Trade Practices Act. This encouraged entry by removing the need for competitors to own infrastructure before they could offer services carried by that infrastructure. It also provided the mechanism for ensuring that any-to-any connectivity would be a reality.

The ACCC initially declared a variety of voice and data based services which were already being supplied by Telstra to Optus and Vodafone during the earlier duopoly period. We subsequently declared additional data and transmission services, including ISDN, to allow more competition in new medium-bandwidth services important for data and Internet applications.

More recently we declared several local access-based services, including an unbundled local loop service to encourage competition in the markets for local voice services and broadband services, and a broadcast access service on cable networks.

Of course, declarations only establish the right of an operator to access the facilities of another carrier. Frequently the terms and conditions of that access have also been the subject of ACCC attention. Access declarations and access pricing are critical to the emergence of competition in the industry. They ensure that there are no distortions in the build or buy decisions being made by entrants. The fact that we have seen both interconnection and new network construction in the post-deregulation period suggests that this process is working.

In late 1999, the ACCC decided not to declare a technology-neutral subscription television service limited to line links. It is the ACCC's view that declaration at this stage would not promote the long-term interest of end users. While overseas developments demonstrate a growing level of demand for digital broadcasting services, there is still considerable uncertainty about the nature and extent of consumer demand in Australia given that digital terrestrial services have not yet begun and are likely to influence the nature and timing of digital broadcasting by cable operators. It has also been suggested to the ACCC that the introduction of digital subscription broadcasting would provide so much additional capacity that it would be easy to accommodate service providers wishing to access customers directly via cable networks.

The ACCC will monitor the deployment of digital services, and will continue to review whether there is any case for establishing an inquiry into declaration of such services.

Detailed analysis of the operation of the telecommunications access regime in the Trade Practices Act is currently being undertaken by the Productivity Commission in its Review of Telecommunications Specific Competition Regulation. The ACCC will make a detailed submission to this review. Pending this submission, I do not think it appropriate to make further comments at this time on the access regime

Broadcasting specific regulation

There is also broadcasting specific regulation in the form of the Broadcasting Services Act. But it is not specific competition regulation. The Act is a mix of social, cultural and economic objectives.

For example, the Act seeks to facilitate the development of an efficient and competitive broadcasting industry while also seeking to promote a sense of Australian identity, plurality of opinion and diversity of ownership through restrictions on foreign and cross-media ownership and control.

I express no view on the appropriateness of the Broadcasting Services Act in a convergent world. There have already been a number of inquiries and reviews that have expressed considered views on this issue.

However, I will express the ACCC's view that broadcasting should not in any way be exempted from the application of the Trade Practices Act. In accordance with the fundamental principle embodied in the Competition Principles Agreement of uniformly applied rules of market conduct, the Act should continue to apply to broadcasting equally as it applies to other industries.

Enforcement strategies in a convergent world

In seeking to enhance economic efficiency and consumer welfare, competition authorities seek to promote competitive market structures and competitive conduct within those markets.

The degree of competition is significantly influenced by the structural features of markets, in particular the number of competitors, market concentration, barriers to entry, import competition, countervailing power and vertical integration.

For example, in a concentrated market, market power may arise and may be mis-used to hinder competitive entry and competitive conduct. Because of a lack of competition, the market will fail to deliver economic efficiencies and consumer benefits. The market structure has led to market failure.

Convergence has the potential to create more competitive market structures. This is a central conclusion of the Convergence Review. It can result in competitive outcomes mainly because of new commercial opportunities opened-up by digitalisation:

- it permits the same service to be delivered over different delivery technologies (eg, broadband cable, satellite or wireless), thus encouraging investment in new competitive carriage facilities; and
- it allows services to be customised to suit consumer preferences, thus promoting the emergence of innovative third party service providers (providing either content-based services such as pay TV or transaction-based services such as e-commerce); and
- it facilitates connectivity between networks, thus allowing for the emergence of telecommunications resellers and Internet Service Providers offering any-to-any connectivity.

The Review does recognise, however, that market failure is the principal threat to capturing the benefits of convergence restructuring.

Change is in the air but it would be a brave person indeed to predict what will be the outcomes in terms of future market structures. But equally as there are new entry opportunities, there are opportunities for market foreclosure. This is a competition fundamental that will still apply in the new digital era as sure as night follows day.

And the ACCC will continue to vigilantly apply competition law in the new digital era. It must if the benefits of convergence are to be realised for the consumer. It is not a matter of 'backing off' because of what some see as the inherently competitive nature of convergence.

The convergence of 'point-to-multipoint' broadcasting services with 'point-to-point' telecommunications services into a more comprehensive 'communications' service has important competition implications. A range of distinct services are increasingly being delivered over the one network ('full service networks'). These services are then being marketed as bundled services, often with a discount when particular bundles of services are taken.

Digitalisation seems likely to create further economic incentives for full service networks. A consequence is that access will increase in importance: access to distribution infrastructure and access to content are likely to become major competition issues.

Access to distribution infrastructure

With the trend to full service networks, economies of scale and scope would be expected to increase. Should these economies be significant, it is likely that there may be fewer digital networks compared to the analogue environment where each type of service was usually delivered over a discrete network. This may particularly be the case in respect of the high cost connections to individual homes or offices.

Ultimately, there may be only the one broadband connection to the home or office, with the infrastructure provider taking on a gatekeeper role in respect of all telecommunications and broadcasting. In such circumstances, access to the digital distribution infrastructure would become critical to the commercial viability of a service provider.

In those situations where there is vertical integration such that carriage and content provision is within the one entity, there may be incentives for the vertically integrated carrier to deny access to content providers who rely on access to the carriage service but are downstream competitors to the vertically integrated firm in content provision.

Access to content

Access to content and particularly pay TV content is emerging as a critical competition issue in the era of convergence. It has been of sufficient concern for the ACCC to make a submission on the issue to the Telecommunications Service Inquiry currently being chaired by Tim Besley.

The Telecommunications Service Inquiry is assessing the adequacy of telecommunications services in Australia. A particular reference is to look at market models that are likely to enhance the delivery of telecommunications services in regional areas.

A number of companies are rolling out, or plan to roll out, broadband cable networks in regional areas. Current roll outs include Neighborhood Cable in Mildura and Ballarat and TransACT in Canberra. Roll outs are being planned by SouthTel on the south coast of NSW, OranTel in Orange and Bathurst and iiNet in WA.

These networks will provide much needed facilities-based competition in regional areas and have the potential to provide a range of telecommunications services such as telephony and high-speed Internet services at competitive prices.

These networks also have the potential to deliver a range of video services including pay TV broadcasting services.

Convergence has created these opportunities. In particular, it is digitalisation that has

enabled different types of services to be transmitted over the one network

In broadcasting, content is king. I don't think this is in dispute. The ACCC submission points out that pay TV programming quality can also be a key factor in the up-take of bundled services delivered over these cable networks.

It further makes the point that pay TV revenues generated from bundled services, and economies of scope can be critical to funding the costs of broadband cable roll outs.

Economies of scope are particularly important. As the UK telecommunications regulator, OFTEL, has commented:

The ability of high bandwidth networks to exploit the economies of scope between telephony and television has been of central importance to the investment in the UK and the development of competition in telephony and television. Cable companies have made commitments to invest on the basis that they would have this ability and without it there would probably not be a viable UK cable industry.

Without access to quality pay TV programming, the necessary revenues may not be available to fund cable investments. Without this investment, an important source of facilities-based competition in regional areas may be hindered or foreclosed.

In Australia, the pay TV industry is characterised by a high degree of vertical integration between program suppliers, transmission providers and the retail pay TV service providers. This integration has been achieved through either long-term exclusive distribution contracts or common ownership.

Vertical integration in programming can be used to hinder or foreclose competition in downstream pay TV markets by denying access to the key pay TV programming which a new entrant needs in order to viably enter a market.

The ACCC is aware of difficulties faced by certain cable operators in gaining access to certain key programming. However, after inquiries, the ACCC came to the view it was not able to effectively deal with this important issue under the general competition provisions in Part IV of the Trade Practices Act.

Generally under competition law, market power must be found before the law can be effectively invoked. At this stage market power may not exist in program supply sufficient to invoke competition law.

Nonetheless, the ACCC considers that vertical integration has enabled the vertically integrated players to inhibit new competitive entry into pay TV and related telecommunications markets, especially those in regional Australia.

The issue is particularly important because, in the ACCC's view, denial of access to key programming can be a critical stumbling block to the enhancement of telecommunications services in regional areas.

Program access regime

The Besley Inquiry is to provide advice to the Government on whether any changes to Government policies are required.

The ACCC has recommended that the Inquiry advise the Government on measures to overcome difficulties in gaining access to programming where that programming is considered necessary for economically viable entry into pay TV and related telecommunications markets.

The ACCC particularly recommended that the Inquiry consider elements of the US program access regime as being economically worthy of implementation in Australia for the ultimate benefit of consumers, particularly those in regional Australia.

It is suggested that an Australian regime could include the following prohibitions on vertically integrated pay TV operators and program suppliers:

- a prohibition on exclusive program supply contracts in the pay TV operator's service area, unless it is in the public interest (eg, the promotion of competition or efficient investment in infrastructure);
- an absolute prohibition on exclusive program supply contracts that cover territories which are not in the pay TV operator's service area;
- an absolute prohibition on the pay TV operator sub-licensing in unserved areas; and
- a prohibition on the program supplier discriminating between competing pay TV operators on the price and terms of program supply.

The US regime was instrumental in the introduction of facilities-based competition in pay TV. A similar regime in Australia, it is considered, would be instrumental in the introduction of facilities-based competition in not only pay TV but, of more national economic importance, telecommunications.

Convergence has the potential to create competitive market structures. Our strategy as a competition enforcement agency must be to seek to realise these potentials and not have them foreclosed by anti-competitive conduct.

Merger Activity

Another issue of relevance for the ACCC is increased merger activity as markets in which convergence has facilitated new entry seek to rationalise in the pursuit of economies of scale and scope. Changing economies of scale and scope are likely to generate new types of merger activity. Mergers between firms operating in essentially different markets have become commonplace. Mergers between media companies in different markets such as Time and Warner, Cap Cities ABC and Disney, Viacom and CBS have been overtaken by mergers between distribution and content such as AOL and Time Warner and Vivendi and Universal. In Australia Telstra has been rumoured to be linking to a media company.

Cross-border mergers are creating global telecommunications firms. It may be that new competition issues arise as a result of the operation of these firms across a number of jurisdictions.

Market definitions are likely to change. The ACCC has previously taken narrow market definitions based on demand factors and limited possibilities for supply side substitution. These definitions may change. For example, in an environment of digital multi channel free to air television, it may be that the ACCC's current market separation of pay TV from free to air would be inappropriate. Web TV might blur the distinction between Internet and television.

These mergers and acquisitions are not necessarily a threat to competition. Firms which have major presence in markets outside Australia may use Australian acquisitions to gain economies of scale and scope from operating in a number of markets. Such acquisitions may increase competition in Australian markets and consequently are unlikely to generate competition concerns.

However, foreign ownership regulation of the media under the Broadcasting Services Act 1992, (BSA) prevent certain acquisitions by foreign firms. Section 57 of the BSA provides that a foreign person is restricted from controlling a commercial television broadcasting licence. Such regulation may be an impediment to international competition.

The cross-media ownership restrictions in certain parts of the media may also impact on the nature of competition which develops as digitalisation encouraged convergence proceeds. The present cross-media laws do not cover all traditional media and have no coverage of emerging telecommunications/media hybrids. It may be that some of the concerns which led to cross-media ownership restrictions and restrictions on foreign ownership might be diminished if more competitive market environments emerged.

The ACCC has no expressed views on what policy options are preferable in terms of meeting the economic and social objectives of broadcast legislation. However, it takes the view that the Trade Practices Act should be applied to all industries equally. Convergence is likely to generate new business models and may require a new regulatory environment for media and telecommunications. Regulation governing access to bottleneck facilities is likely to be essential to achieve the competitive benefits of new entry.

The current regulatory framework for telecommunications contains built in review provisions. It is one of those provisions which will see the review, this year, of the telecommunications specific provisions of the Trade Practices Act. It was always the intention of the government, when it introduced the legislation which established the current regulatory framework, that there would be a progression from industry specific regulation to a more general application of the general provisions of the Trade Practices Act. The Productivity Commission inquiry into broadcasting can be seen as the first step in a parallel review of media regulation. Convergence is likely to lead to a harmonisation of regulation as a first step and has the potential to lead to a development of competition which will provide significant benefit to consumers over the next few years.