Submission to the Review of Price Controls Discussion Paper

February 2010

Introduction and Summary

The CCC welcomes the opportunity to contribute to the ACCC's consideration of future price control arrangements. The CCC believes that the conditions necessary for the removal of price controls do not exist.

However, we submit that the extension of price controls into areas of mobile prices should not be contemplated at this time as there are other actions to promote competition that should be employed before the blunt instrument of price controls is employed. Likewise, the CCC does not support a more aggressive rate of reduction of prices subject to these controls. The CCC takes these positions because it believes that price controls do not advance competition, and may in fact have unintended negative consequences for competitors.

The CCC submits that the Commission should consider whether the market for directory assistance should be reviewed for structural impediments to competition as it is not clear how competition will ever develop in that market such that the existing price control will ever be able to be removed.

Background to Controls and Fixed to Mobile Issue

The CCC submits that it is important to keep in mind that the price control regime was originally intended as a transitionary, safety net mechanism. That is, it was a mechanism that was intended to remain only during the period when it was expected that competition would grow and deepen.

Price controls were applied to services that were considered essential basic services for all consumers. It was assumed that competition would develop for these services but that it would do so unevenly. Price controls were intended to protect individual consumers reliant on these services while competition evolved to the point where the controls could be relaxed.

In the event, competition has not developed as expected in any of the service markets that were made subject to price controls. Indeed, there is evidence that the development of competition has stalled in markets for basic fixed line service and in others.

The CCC submits that there is no case, therefore, to remove price controls. Consumers continue to require protection from the potential for Telstra to exercise market power to raise prices unconstrained by effective competition.

It is in this context that the Commission and others have, in recent years, increasingly proposed that the Government extend, rather than withdraw, price controls.

However, the CCC submits that the expansion of price controls is not a remedy to the failure of policy and regulatory settings to develop sustainable competition.

The CCC has for many years argued that the structure of the industry, and specifically the very high degree of vertical and horizontal integration of Telstra, was the single greatest impediment to competition. It is pleasing that the Government has acted to address this problem in the medium and longer term through both its measures to create separation of Telstra's network and wholesale arms and the creation of the wholesale-only National Broadband Network.

Other recent developments in policy,such as proposed strengthening of the Part XIB competition notice provisions, and the Government's announcement regarding its intention to make available further spectrum for mobile services, could further expose the retail mobile market to much needed competitive pressure.

In this context, the CCC is concerned that the Commission in the case of fixed to mobile retail prices seems to be considering the use of price controls for purposes for which they were never intended, nor for which they are suited, while putting aside necessary action on wholesale prices.

The CCC agrees that it is not acceptable that Telstra in particular appears to have not passed through price reductions at the retail level. Of particular concern is that Telstra has used these additional margins to cross subsidise FTM in competitive markets from market that are not competitive.

It must be noted that Telstra benefits from margins across the range of voice services that competitors do not enjoy. Basic wholesale services such as line rental, local call service and wholesale DSL represent minimal or negative margins for competitors. Competitors cannot cross subsidise across services in the way that Telstra can and does. Nor can competitors cross subsidise FTM prices between different users to the degree that Telstra can and does.

However, the CCC has several concerns with the Commission adopting an approach that requires pass through of wholesale price reductions through the blunt instrument of price controls. The CCC is especially concerned that the Commission appears to be saying that the inadequate pass through of wholesale prices has influenced its decision to not further reduce wholesale prices.

We submit that this is not a reasonable position.

The CCC principle concerns with the fixed to mobile price control proposal include:

- The way the retail market responds to wholesale rates being regulated toward cost is a separate matter to the obligations on the Commission to regulate wholesale prices consistently with its own principles that wholesale prices should be cost reflective. A failure of these wholesale price reductions to be passed through reflects retail market power. The Commission should not point to FTM retail rates and suggest that the Government introduce a price control while simultaneously declining to continue making reductions in wholesale rates if its own analysis suggests that the present wholesale rates continue to be materially above cost.

- Price controls do not reduce retail market power. The price control regime is not intended to perform a role in stimulating the reshaping of markets to inject competition. This is the role of the application of the regulatory tools provided to the Commission by the Government, and the role of Parliament and Government in determining the appropriate policy settings. Price controls are intended simply to protect some consumers from the exercise of market power.
- The introduction of a price control could create disadvantage to other retailers that are not in a position to exercise market power, affecting them more than it affects those with market power. In so doing, they potentially further weaken competition and worsen the basic market failure problem. For example, there is no formal relationship between a Ministerial determination on price controls and the activity of the Commission that would require the Commission to act to reduce regulated wholesale MTAS rates if the Minister were to implement a retail price control on FTM. Given recent conduct by the Commission, the CCC has no confidence that the Commission would revisit wholesale MTAS prices in the short term if that would open it to criticism by Telstra and Optus even if a price control was implemented on FTM by the Government.
- The Commission's concern that retail rates have not fallen commensurate with past wholesale rate reductions is not consist with the Commission's past acceptance that pass through can occur in ways other than simple FTM price falls. Nor is the introduction of a price control on FTM consistent with these past positions. The Commission accepted in the past that there should be a degree of flexibility to allow input cost savings to be reflected in different ways according to what is most efficient for individual service providers. If the Commission has chosen to depart from this principle, it should at least further reduce wholesale rates to cost <u>ahead</u> of action on FTM retail prices.
- Therefore, those most likely to be financially disadvantaged by the introduction of retail price control on FTM would be fixed line competitors and non-integrated mobile carriers. These companies are the agents of increased competition in fixed and mobile markets, and the Commission should be concerned with fostering competition with a view to the eventual removal of price controls, not using the blunt instrument of price controls in ways that retard their ability to extent competitive pressures on incumbents.

Finally, the CCC believes that actions by the Government to address structural market failure in all communications markets are more likely to have the effect of stimulating competition in all markets than any action since 1997. The introduction of a retail price control on FTM in the interim is likely to harm competitors at a time of great uncertainty.

However, the Commission should utilize the other regulatory tools that successive Governments have provided to it to address the conduct in the market that Telstra has employed to retard competition. Specifically, if the Commission is concerned that too retail rates for the consumer market is resulting in cross subsidy that it harming competition, it must have the courage to employ the Part XIB anti-competitive conduct tools to test the extent to which Telstra can cross subsidise FTM rates for large customers at the expense of the consumer market and competitors.

Changes to CPI X

As discussed above, the CCC believes that the competition has failed to develop as it should have done for voice services that are subject to price control, and that Australian consumers are suffering as a result. In particular, Telstra continues to over recover across the range of fixed line services where it has the ability to leverage vertical market power.

This situation has been exacerbated in recent years by decisions by the Commission that have disadvantaged competitors relying on accessing the Telstra bottleneck services that were intended to bring competition to the market for these basic services.

Specifically, the Commission's decision to exempt certain areas from regulation on the basis that they were potentially competitive, and the Commission's failure to follow through with reductions in indicative prices for wholesale services have created great uncertainty about the security of commercial arrangements into the future, undermined past capital investment and driven confidence in the regulatory system and the regulator to new lows.

Changes to the price controls mechanisms cannot remedy these issues but could exacerbate the problems faced by competitors operating in the markets for basic services. If the rate of reduction of the price control on basic voice and line rental services was aggressively increased without a commensurate decision by the Commission to revisit its decision not to act on wholesale prices, the already thin margins available to competitors would likely be further eroded.

That is, there is a serious risk that aggressive price control reductions would lead to a further misalignment between wholesale and retail prices, creating greater detriment to competitors than Telstra, and further exacerbating the unfriendly conditions for competition that have led to price controls becoming a seemingly permanent feature of the regulatory regime.

However, the CCC believes that the policy approach announced in 2009 by the Government and presently being considered by the Parliament represents a serious attempt to address the underlying structural problems that have hamstrung competition. It is a stated aim of the Government to seek to ensure that competition is protected and encouraged in the period where these structural changes are put into effect so that the benefit of these changes can be felt as quickly as possible.

In that context, the CCC urges the Commission to consider the impact of changes to price controls in the context of the present review holistically and cautiously. At the very least, the Commission should act on its own account to reduce wholesale indicative rates by the same amount as it recommends retail price controls are reduced, in order to avoid misalignment between wholesale and retail rates in the market.

Directory Assistance

The CCC submits that the price control on directory assistance reflects a deeper problem in that market, and one that the Commission could appropriately refer to the Government as being in need of policy consideration.

The directory services market is structurally uncompetitive in Australia because it has not been subject to the reforms that have been implemented in the directories assistance market of many other countries, including the UK, to encourage market entry.

The CCC believes that there is evidence that consumers have enjoyed significant benefits from the opening of directories markets to competition in these other markets.

The existing directory assistance price control requiring Ministerial approval for a price rise by Telstra reflects the fact that consumers, in practice, do not have a choice to use alternative services without changing carriers.

The CCC submits that the Commission should recommend the existing price control continue but that the Government look to the overseas experience and introduce genuine competition to this market. In the absence of such reform, it is unlikely that the price control could ever be safely removed. However, effect market reform could allow it to be withdraw in the future, consistent with the intention that price controls should be temporary mechanism.

There is a risk that the directory assistance market could be "unfinished business" unless it is the subject of a policy review at the same time as the Government is engaged in sweeping reforms of other parts of the communications industry.

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