



**Regulating competition in converging markets:  
telecommunications and broadcasting**

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## **Introduction**

Ladies and Gentlemen.

The digitisation and convergence of broadcasting and telecommunications services, networks and platforms is underway. The traditional shape of these markets is beginning to shift and alter.

This is challenging established systems – particularly regulatory structures.

Where there is good regulation, open competition is facilitated. But where there is bad regulation market shapes are often rigid and inflexible.

Economic change – globalisation, deregulation, the impact of new technologies – have worked well for consumers and competition. But we need to be vigilant about the potential for these changes to lead, in some cases, to new forms of market power, new forms of anti-competitive practices and new consumer scams. They represent ongoing challenges to consumer protection and competition law.

These are important issues in the telecommunications industry now – and the foreseeable future – and it's what I want to discuss with you today.

## **Key regulatory challenges of convergence**

While there are likely to be many regulatory challenges from convergence – some that we cannot envisage now – there are two that are fairly obvious.

Firstly, the potential for Telstra to leverage its extensive market power into other industries and markets.

Secondly, how to resolve the disparity between the competition regulation in different markets – most particularly broadcasting and telecommunications.

The telecommunications industry has clearly transformed over the last 6 years.

- ? Despite some recent rationalisation, there are many more players.
- ? An expanding range of services is being offered.
- ? Prices have reduced most obviously in the markets for international long-distance and mobile calls.

Open competition and technological change have delivered some of the benefits of competition to the consumers of telecommunications services – the price of a full range of telecommunications services has declined by 21.4% in real terms between 1997-98 and 2000-01<sup>1</sup>.

However, the Commission's analysis is that the various telecommunications markets are not yet effectively competitive – the levels of effectiveness vary greatly across the different telecommunications markets.

In the local call services market competition has had very little impact. Telstra owns the only ubiquitous customer access network.

- ? Telstra's wholesale share of this market is 94.1%, including basic access lines resold by its competitors.
- ? Its main challenger is Optus, whose market share is only 5.9%.
- ? Limited competition does occur in most metro areas, but there is no competition in less densely populated areas – and no sign that this will develop in the near future.
- ? The ubiquity of Telstra's network means that in order to reach potential customers, all other providers must at some point interconnect with Telstra.
- ? Telstra's control of the customer access network allows it to have significant influence over the retail prices of its competitors in all markets where access to the network is necessary.

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<sup>1</sup> There was a 21.4% reduction in the price of a full basket of telecommunications services between 1997-98 and 2000-01. ACCC, *ACCC telecommunications reports 2000-01*, Report 2: Changes in prices paid for telecommunications services in Australia, p 72.

? To give you an idea of proportion, the customer access network generates about \$6 billion a year in revenue for Telstra, which is roughly 60% of total fixed telephone revenue.

Despite the appearance of strong competition in the national long distance and international call markets, there is also evidence of ineffective competition.

- ? Telstra has about 48% of this market.
- ? Optus has about 18%.
- ? There is some facilities based competition from smaller entrants – on major long-distance transmission routes, particular between the capital cities.
- ? But there is no effective competition on non-major routes.
- ? And again, most suppliers of long distance and international calls have to access Telstra's network to reach their potential customers.

With regard to mobile telephony services, the Commission believes a distinction needs to be made between calls made between mobile consumers, and those made from fixed lines to mobile services. For mobile-to-mobile services, competition at the retail level appears to be reasonably well established. It was further enhanced by the introduction of mobile number portability in 2001.

- ? Consumers now have a choice of around 13 mobile providers, including resellers.
- ? While Telstra still leads the market with a market share of 43.5%, it is closely followed by Optus (32.6%) and Vodafone (18.3%), with the remainder of the market (5.6%) split between other players.

For fixed-to-mobile services, the retail market has been growing in recent years – so much so that Telstra's recent half-year report shows it now earns more revenue from fixed-to-mobile services than it does from national long distance services. This is despite the fact Telstra carries more than double the number of national long distance minutes than it does for fixed-to-mobile services.<sup>2</sup>

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<sup>2</sup> Telstra's recently reported half-yearly retail revenue for fixed-to-mobile and national long distance services was \$746 million and \$579 million respectively. The combined wholesale and retail minutes carried for each service was 1,955 million and 4,656 million respectively. Whilst minutes include both wholesale and retail, wholesale minutes represent a very low proportion for each service.

Unlike the market for other fixed line services – such as national and international long distance – there has been relatively little reduction in the final prices paid by consumers in recent years for fixed-to-mobile services. Further, and perhaps relatedly, there appears to be limited competition in terms of wholesale mobile termination.

What these figures demonstrate is that Telstra retains a commanding market share across a broad range of telecommunications markets.

It has extensive market power, derived not just from this market share but from its control of inputs essential to the provision of downstream services:

- ? It is one of the most horizontally and vertically-integrated telecommunications companies in the world.
- ? It controls the local fixed-line telephone network.
- ? Is the largest mobile carrier with 2 advanced digital mobile networks.
- ? It is the largest retail ISP.
- ? It is the largest provider of wholesale data and Internet service.
- ? It controls 50% of what is effectively the only wholesaler of pay TV content.

Recent analysis by the Commission shows that in the last year or so progress in achieving effectively-competitive telecommunications markets has slowed – there has been little change in the number and size of industry players and slowing price decreases.

The global downturn in telecommunications markets will have had a large impact. However, the industry structure – in particular Telstra's network ownership and the integrated nature of its operations – is a key factor.

Despite the emergence of some facilities-based competition, principally in the central business districts of major capital cities, few of Telstra's competitors have any real alternative to the extensive use of Telstra's network services as an input to providing their own services.

I made similar comments to these in a speech that I gave to the ATUG NOW 2003 conference in early March. Not surprisingly, Telstra did not agree with my comments. I would like to take the opportunity to respond to a few of their public comments.

Telstra argued that the ACCC's only indicator of the effectiveness of competition is a reduction in Telstra's market share and that the ACCC measures its performance by the amount of help that it gives Telstra's competitors.

- ? The Commission uses many measures to assess the level of competition in markets – vertical and horizontal integration, market behaviour and outcomes as well as market shares.
- ? And it is not the Commission's role to protect the interests of the shareholders of Telstra or any other market participant, rather it is to ensure the long term interests of end users of telecommunications services.

Telstra also commented that Australia's regulatory regime is one of the world's most intrusive. However, other developed economies have far more extensive regulation than Australia.

- ? Unlike the US and the UK, the Commission does not set interconnection charges.
- ? Unlike New Zealand, which has extensive wholesaling obligations to a range of services – obligations that are comprehensively used by Telstra as a new entrant in that country – in Australia wholesale obligations only apply to local calls.

I would also add that neither British Telecom nor any of the US telecommunications companies have the same level of integration, market dominance, and, in the US case, national coverage, that Telstra does.

Some industry participants seem to believe that less than effective competition is not the result of Telstra's market power, but of the Commission setting access prices too low. The Commission has responded to such criticism on a number of previous occasions, but the point is worth making again today.

- ? There is no evidence to indicate that investment has either declined or not taken place as a consequence of regulation.
- ? The Commission's approach to pricing is consistent with approaches adopted in most other economies with liberalised telecommunications markets. Arguably, it has been quite generous in its pricing as it has allowed additional charges such as an access deficit contribution that other regulators do not.
- ? In determining prices the Commission assesses costs generously and the cost of capital compares favourably with market returns more generally.
- ? Telstra has generated and continues to generate high profit margins and a high return on equity in many of its core retail services, well above its capital costs or required return to its investors.
- ? Its very high profits and history of high investment in recent years are also hardly consistent with regulatory under-pricing.

To return to my main point, there are some clear examples in the past of Telstra using its market power to stymie access. For example:

- ? It took 9 months to alter its conduct regarding wholesale ADSL access despite consistent pressure from the Commission, including issuing a competition notice.
- ? In analogue pay TV markets, despite declaring the service, arbitrating a number of access disputes, and issuing interim determinations, there was still no outcome.

While these are more obvious examples, the impact of Telstra's market power is often more subtle.

The threat of Telstra gaming the regulatory regime – particularly the threat that it would appeal an arbitration decision made by the Commission to the Australian Competition Tribunal – constrained the actions of Telstra's competitors.

- ? The Government's recent decision to remove merits review from final Commission determinations will limit this particular avenue in the future.

Telstra's control of market information – in particular knowledge derived from its control of downstream inputs – means that access seekers are often negotiating in the dark.

? The Commission has sought to provide information to the market via the release of indicative prices – the Government’s decision to implement benchmark terms and conditions for core services will also assist in informing the industry.

Telstra’s market power is the predominant issue in the regulation of current telecommunications markets. It threatens to limit and stymie the emergence of fully effective competition in the telecommunications industry.

As a dominant telecommunications incumbent, Telstra is always going to be particularly concerned about the entry of new firms potentially with technological advantages, or that otherwise diminish existing market power. In response it may seek to leverage market power from established telecommunications markets – such as basic access and local calls – to stifle new entry.

Telstra could also potentially leverage its market power into emerging telecommunications markets. Good examples are third generation (3G) mobile and broadband services (particularly via DSL delivery on the PSTN and via cable) and digital TV, which is delivered via satellite and cable networks.

There are significant potential problems in Telstra leveraging market power into emerging markets – there could be great harm caused to emerging markets from extending market power derived from more established markets.

? It could limit new opportunities for the introduction of facilities-based competition (eg Hutchison in 3G), which can break-down existing market power.

? It could have a significant impact on innovation.

With convergence, this becomes of even greater concern as Telstra would be in a position to leverage its market power into emerging markets and markets for the delivery of new services. It is possible that its existing market power may be transferred into new markets and limit opportunities for new entry or be used to stifle the development of new services.



This may reinforce or protect existing market power and restrict the prospect of greater competition arising through new entry or between incumbents as a result of innovation.

Convergence with broadcasting markets presents particular concerns, given the lack of competition within the broadcasting industry.

This market does tend towards concentration.

- ? Barriers to entry are high.
- ? It is characterised by economies of scale and scope – that is cost advantages accrue to firms as a result of large production runs (because per unit costs are reduced), and accrue to firms that employ a single facility to produce a diverse range of goods and services.

That said, the broadcasting industry is heavily regulated, and this regulation has acted to stymie the operation and shape of the market, and has clearly reduced competition. A high level of legislative protection is afforded to incumbent free-to-air broadcasters, a level of protection not given to firms in other industries.

Despite 'room' being available for one more channel in capital cities, and despite a number of proposals for a sixth channel, such capacity has only ever been filled on a temporary basis by community broadcasters.

The grounds for rejecting a fourth commercial licence are sometimes presented as a desire to ensure viability, which in this context is not the viability of a broadcasting market, or the viability of Australian content, but the viability of incumbent commercial licensees.

- ? Indeed, until the Broadcasting Services Act 1992 was enacted, viability was a licence criterion, and had been used to restrict entry.
- ? As a consequence there has been no significant new free-to-air entry in capital city markets since the mid-1960s.

Most recently, the banning of a new commercial television network to facilitate investment in digital technology by incumbent broadcasters has come at the cost of increased competition.

There are also significant and important differences in the way spectrum licences are provided for broadcasting and telecommunications, which become increasingly important with convergence.

? Free-to-air don't have to bid for spectrum, while some pay TV and telecommunications operators must pay for spectrum.

Restriction on competition leads to other obligations for incumbents, thus increasing barriers to entry. For example, Australian content laws require the development of more expensive local content.

The broadcasting industry is clearly the exception to Australia's liberalisation policies.

While ultimately the processes and outcomes of convergence remain somewhat uncertain, the absence of effective competition in broadcasting markets now, may serve to restrict the nature of convergence to what suits the interests of dominant firms and close the avenues for new competitors.

A good way to illustrate the impact of convergence between telecommunications and broadcasting markets is to examine the pay TV industry in a little more detail.

The Foxtel/Optus content sharing arrangement was a defining moment for the pay TV industry.

The Commission accepted court enforceable undertakings from Foxtel, Optus, Telstra and Austar in relation to these arrangements in November 2002.

We made it clear at that time that the undertakings were not intended to alter the pre-existing competitive landscape in the pay TV industry, and that the Commission's decision related to the specifics of the case under consideration.

In this case there was evidence that the competitive position of Optus in the market was being adversely affected by its inability to access and supply key content to its customers. The content sharing arrangements should enable Optus to improve its programming and ensure consumers are offered a better quality pay TV service.

The court enforceable undertakings accepted by the Commission last November will also provide for rival pay TV operators like TransACT and Neighbourhood Cable to purchase a more comprehensive range of programming. This will enable them to offer consumers a broader range of programs including popular movies and sports.

It should also allow rival pay TV operators to use Foxtel and Telstra's analogue and proposed digital pay TV infrastructure – such as Telstra's cable network and Foxtel's set-top boxes – to provide competing services to consumers. However, there are a number of processes still to be completed, so even here there are no complete outcomes at this time.

The Commission is also now considering an application lodged by Telstra and Foxtel in which they are seeking an exemption from access obligations, should they go ahead with the digitisation of the Telstra cable and Foxtel's set top units. I must emphasise that this is a different and separate task to the consideration of the undertakings that occurred in November.

However, as I have noted above the Commission continues to have broader concerns about the level of competition in the broadcasting industry.

In particular, Telstra's ownership of an HFC network and its interest in Foxtel places it in a unique position to unduly influence and benefit from the increasing convergence between telecommunications and broadcasting markets to the detriment of competition.

Further, Foxtel has the ability to limit access to pay TV channels as a result of the exclusive basis upon which it acquires premium pay TV content (such as sport and

movies). Also Telstra's interest in Foxtel reduces the incentives for Foxtel to supply channels to competing telecommunications service providers.

The Commission is also concerned about the impact of bundling of services across the pay TV and telecommunications markets. This is particularly difficult to assess as bundling brings both costs and benefits.

Bundling has the potential to provide significant benefits. Firstly to the carrier or service provider that is supplying bundled services, as it can:

- ? Result in greater efficiencies;
- ? Allow suppliers to exploit economies of scope between bundled goods, and economies of scale if the bundling has a major impact on consumer demand;
- ? Provide a cost effective way of marketing goods and services to consumers, and
- ? Allow suppliers to set prices so that profits are maximised and efficiency increased as they are able to discriminate between the price of services when they are supplied as a part of a bundle or individually,

Secondly, assuming markets are competitive, consumers can benefit through:

- ? Economies of scope and scale are passed on as lower retail prices or quality improvements;
- ? Lower transaction costs by buying a range of related and compatible products from a single supplier; and
- ? Receiving one bill for a range of different services

Conversely, however, bundling can be highly anticompetitive leading to extremely high costs.

- ? In competitive markets with few firms, a carrier or service provider may use bundling as a strategic tool – while this may offer short-term benefits it can cause long-term harm if competition decreases.
- ? They may also use bundling for anti-competitive purposes or resulting in anti-competitive effects which again can be detrimental for consumers and competitors of the carrier or CSP supplying the bundled services.

- ? Bundling could foreclose or reduce competition by enabling the carrier or supplier to leverage market power from one market to another. In this way bundling can diminish competition or significantly reduce the ability of competitors in a particular market—who can not match the scope of a bundle—to efficiently compete against a limited number of bundled providers.
- ? The pricing of a bundle of services may also be anti-competitive, particularly if it is predatory or results in a vertical price squeeze.

The Commission is still considering its approach to bundling, but assesses that it may need to consider bundling on a case-by-case basis.

I would note that the Commission is currently finalising a report to the Minister for Communications, Information Technology and the Arts on emerging market structures and their impact on competitive outcomes.

The report will be provided to the Minister soon and I do not wish to pre-empt what we will say.

Many of the issues that I have canvassed today, however, will be covered in more depth. For example, the:

- ? Key competition concerns that arose during the Commission's consideration of the Pay TV content supply agreements last year;
- ? Current telecommunications and broadcasting market structures; and
- ? Regulation of the pay TV industry, including access to content and bundling.

## **Conclusion**

Addressing Telstra's market power within the current regulatory framework is difficult as the telecommunications access regime operates without any reference to the structure of the industry.

It is generally acknowledged that access regimes have inherent problems.

- ? They may not provide for timely outcomes.
- ? They lead to gaming – from both access providers and access seekers.

- ? They can be a source of uncertainty.
- ? They have significant regulatory costs.

These problems stem from one of the main deficiencies of access arrangements – they do not change the underlying incentives of a firm to provide fair, timely and non-discriminatory access to its upstream inputs where it also competes in downstream markets.

In 2001, the OECD Council of Ministers adopted a recommendation on structural separation of regulated industries urging member countries to seriously consider structural separation when in the process of liberalisation and regulatory reform.<sup>3</sup>

A recent draft working paper from the Communications section of the OECD has expressed some reservations about the practical difficulties of structural separation, but the Ministerial resolution still stands as the expression of agreed OECD views.

In terms of broadcasting, I realise that the industry is regulated with the aim of achieving other policy objectives. It is difficult to calculate the costs and benefits and weighing them up are decisions for policy makers.

However, as a competition regulator, I would argue that two principles should be applied towards regulation.

First it should be competitively neutral – in other words applying equally to all competitors. Convergence of various sectors, particularly electronic media and telecommunications, makes this increasingly important.

Secondly, any legislation that restricts competition should be retained only if the benefits to the community as a whole outweigh the cost, and if the policy objectives can only be met through restricting competition.

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<sup>3</sup> OECD, *Restructuring Public Utilities for Competition*, OECD, Paris, 2001.

Strong competition and appropriate and uniform regulation maximises the benefits to both private and commercial consumers.

### *Dawson Review*

I would like, in conclusion, to take a few minutes to make some comments outlining the Commission's views on some of the specific proposals of the Dawson Review.

The Commission considers that the Dawson Committee recommendation that criminal sanctions be introduced for hard core cartel activities is a major step forward for Australian trade practices law.

- ? This is a necessary step to combat hard-core cartels and we will join our many trading partners in doing this.
- ? This change to the law will be of benefit to consumers, big and small business.
- ? Highly profitable cartels will now become much less attractive to potential law-breakers.
- ? The Commission is confident that the proposed committee will be able to clarify remaining issues in relation to criminal sanctions.

The Commission also welcomes the Committee's acceptance of the ACCC proposal that the maximum penalty for corporations be raised to the greater of \$10 million or three times the gain of the contravention or, in certain circumstance, 10 per cent of the body corporate, including associated companies.

- ? This is in line with international practice and should serve as an enhanced deterrent.
- ? The Commission is pleased that the court will be given the option to exclude an implicated individual from being a corporation director or manager.

The Commission welcomes the Committee's acknowledgment of the important and legitimate use of the Commission's use of the media. The Media Code proposed is essentially consistent with the normal and preferred media policy that the Commission follows and proposed to the committee.

We support the Committee's call for a stronger consultative committee to assist the Commission – this recommendation echoes our concerns and we will move towards implementation of the Committee's suggestions.

We are also happy that the Committee agrees that ACCC is a highly accountable and independent authority – this confirms that the introduction of a further oversight Board, or Inspector General, was neither necessary nor appropriate.

While the Commission welcomes the Committee's adoption of its suggestions to address issues raised by small business in relation to collective bargaining with big businesses (modelling the process on the existing notification process) I would caution that this will not remove all issues in the relationships between small and big business.

The Commission is unsure whether the general recommendations regarding Section 4D (collective boycotts) have merit. The recommendation, however, that only contracts whereby competitors seek to exclude other competitors will be automatically prohibited, is of concern. This will have a serious impact on the Commission's ability to combat agreements between competitors to rig bids, collude in tendering or share markets, all of which are directed at the buyer rather than competing suppliers.

The Commission notes that the committee has not accepted the need for change to section 46 of the Act, dealing with misuse of market power. Some comments are:

- ? The Commission has been active in litigating under section 46 of the Act.
- ? However, there has only been once case since 1991 where misuse of market power has been found to have occurred (Warner Music and Universal) and that is on appeal (these cases generally take six to seven years).
- ? Given the Commission's history of success in other areas of litigation under the Act, it seems unlikely that there has only been one instance since 1990 where big business has used its market power to harm competition.
- ? Thus we must assume that this part of the law works poorly.



- ? Following the recent High Court ruling on Boral, there is further ongoing uncertainty as to the effectiveness of this provision as the court has adopted a restrictive interpretation.
- ? We are disappointed that the Dawson Committee did not have any suggestions for change.
- ? We accept, however, that a review has been held, it has reached a conclusion, and we must live with it.

While the Commission also welcomed the committee's endorsement of the current mergers test and the recommendations aimed at streamlining the process of dealing with mergers, it is concerned about committee proposal that companies be allowed to bypass the ACCC and directly apply for merger authorisation to the Australian Competition Tribunal.

- ? The Tribunal is a legal body with firms represented by legal counsel.
- ? It is a poor venue for consumers and small businesses to use.
- ? The current process is open and transparent.

Further, the Commission is concerned that this process will eliminate the right of parties materially affected by a merger, such as customers, suppliers and competitors to seek a merits review of a merger authorisation.

- ? One of the main proponents of this proposal, the Law Council of Australia, has previously been a staunch supporter and defender of the merits review system in relation to other areas of the law.

Thank you.