



Australian  
Competition &  
Consumer  
Commission

## **Australian Competition and Consumer Commission**

**Promoting Competition and Fair Trading**

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**A competitive telecommunications industry:  
Issues in competition and consumer law**

**Graeme Samuel, Chairman**

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### **INTRODUCTION**

On 10 March 1876, Alexander Graham Bell uttered the first words in cyberspace.

Using the latest and most innovative technology, a ‘harmonic telegraph’, he spoke to his assistant who was waiting in the next room.

His words?

‘Mr. Watson, come here. I want to see you.’

Now, a number of things strike me about this incident.

The first is that human genius reveals itself in astonishing, varied and irrepressible ways.

The second is that the ‘harmonic telegraph’ of 1876 has transformed the world, and is now an intrinsic and vital part of our daily lives. Indeed, mobile phones are so woven into the existence of our young people that to separate them necessitates complex, difficult surgery, painful surgery.

The third thing is that innovation means that the industry and the services provided by industry are being restructured and reinvented at breathtaking speed. Today, using a 3G phone, Alexander Graham Bell would be able to instruct Watson not to bother coming, because he could see him quite well enough.

Today, using my trusty BlackBerry - I receive and send emails, and am notified of changes to my diary. It is, I have to say, an astonishing technology and is a good thing – most of the time.

Today I would like to discuss competition and regulation in telecommunications - how we are going, and what is needed to maintain the level of innovation that works to benefit both individual and business consumers. In doing so, I will focus on two key issues.

The first is the notion of consumer benefit. The Commission's central role in regulation of telecommunications – both its competition and consumer protection roles – always comes back to consumer benefit.

The second is the state of play of competition and consumer protection in the industry itself. I hope this will give you an idea of our priorities in the time ahead.

## **COMPETITION, REGULATION AND CONSUMER BENEFIT**

The Commission's key role in regulating the nation's telecommunications industry is to safeguard consumer benefit. We do this by ensuring compliance with the law, in the public interest, and by encouraging competitive market structures and informed behaviour.

In an ideal world and in a perfectly competitive market, the need for regulation would be slight. Competition itself would do the work of the regulator – efficiently, effectively, without undue bother.

Indeed, the Commission is guided by a fundamental desire to have markets operate in a competitive manner. We regulate markets because the regulation of uncompetitive

markets is a necessary task, but we understand that this will only ever approximate the net benefits to consumers generated by competition.

The concept of consumer benefit occupies a central position in the Trade Practice Act, (the Act) and is spelled out clearly in the telecommunications specific provisions.

The objective of the telecommunications access regime is to promote the long-term interests of end-users. This long term interest is described by three criteria:

- The promotion of competition
- The realisation of 'any-to-any' connectivity, and
- The economically efficient use of, and investment in, telecommunications infrastructure.

Long-term consumer benefit is the basis upon which the Commission regulates access to telecommunications services: a decision to declare a service, to grant an exemption from access obligations, or to set prices in an arbitration are all guided by this objective.

This means that we promote competition not because it is an end in itself. Instead, we seek it because it generates significant benefits both for consumers and the industry.

What are these benefits?

Last year the Australian Communications Authority (ACA) estimated that the 1997 changes to the telecommunications regulatory regime led to net benefits to consumers of telecommunications services that, per household, totalled between \$600 to \$850 in constant terms.<sup>1</sup>

The ACA also estimated that the economy is \$10 billion larger than it would have been without these reforms.

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<sup>1</sup> Allen Consulting Group, 'Benefits Resulting from Changes in Telecommunications Services', a report for the Australian Communications Authority, October 2002.

Outputs by various industries have expanded – including those industries that supply products to the telecommunications industry and those that benefit closely from increased telecommunications output.

Not surprisingly, the telecommunications industry itself is reckoned to be the biggest beneficiary, with output being 75 per cent higher in 2001-02 than the no change case.

Does this mean that the telecommunications industry is now fully competitive?

## **STATE OF PLAY**

If we are to assess the state of play in the Australian telecommunications market, some facts are clear.

There are many more providers of telecommunications services competing to offer different services and technologies. Some infrastructure has been built, and acts to provide competitive choice. This is particularly the case in the central business districts of major capital cities and some metropolitan areas. There has been an enhanced focus on the delivery of telecommunications services to consumers.

Benefits have accrued to consumers. Prices for most per call services have dropped over the past four years. The average price paid for telecommunications services has declined by about 21 per cent between 1997-98 and 2001-02.

Calls between fixed to mobiles declined by about 21 per cent and international call prices dropped by about 60 per cent.

While there are signs of competition in national long-distance and mobile services, these markets are not yet effectively competitive and the markets for local call and fixed-to-mobile services are a long way from being effectively competitive.

As well, there is now evidence that progress is slowing in achieving competitive telecommunications markets.

The number and size of industry participants barely changed in the past few years.

Recent Commission analysis shows that the rate at which prices are falling has slowed. The average price paid for telecommunications services for 2001–02 fell by 2.7 per cent in real terms, the lowest percentage fall since 1998–99.<sup>2</sup>

Also of concern, the benefits of price decreases are not being shared evenly across consumer groups. For PSTN services in 2001-02, prices fell for residential consumers by 2.2 per cent. And medium to large sized business benefitted from a fall in price of about 4.7 per cent.

Over this same period, prices for small business increased by 2.4 per cent.

So while there are clear benefits to end users, the extent and depth of competition varies greatly across different markets.

There are a number of explanations why this should be the case.

The collapse of One.Tel during the 2001-02 monitoring period will have affected the prices paid for PSTN services - One.Tel discounted aggressively to gain market share and this was reflected in prices for that year.

Although carriers are still competing vigorously for new prepaid customers – a rapidly growing market segment – the market for post-paid mobile telephony services may be reaching saturation. This will have an effect on the overall price of mobile services.

Smaller PSTN decreases are also due to the continued process of rebalancing the structure of prices of PSTN services that has been occurring over recent years.

But we cannot discount that there are underlying structural problems within the industry itself that are impeding the development of more competitive markets.

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<sup>2</sup> There are many possible reasons for this slowing of price decreases, including the exit of One.Tel late in the 2000–01 financial year or industry consolidation.

The Australian telecommunications market remains defined by the fact that Telstra wields extensive market power despite some more encouraging recent results by competing providers.

A few weeks ago Optus announced its latest half yearly results. Revenue grew in the latest half year by 19 per cent to an annual rate of \$6 billion. EBITDA rose 43 per cent.

Taking heart from this, Robert Gottliebsen wrote in *The Australian* that if Optus continued to grow at this rate, and Telstra also continued to grow at current levels, Optus would be half the size of Telstra in a few years.<sup>3</sup>

As we recently saw, the fact that the Wallabies won the World Cup in 1999 was not sufficient reason to guarantee them victory last weekend. The past is a notoriously poor indicator of the future. Not expectedly, Gottliebsen indicated that Telstra was not prepared to lose further market share.

The fact that Telstra can draw a line in the sand and effectively say, 'Thus far, and no more', is not solely a function of market share or deep pockets. In part, Telstra's stance is a consequence of its control of inputs that are essential to the provision of downstream services and high levels of vertical integration.

Telstra is a major wholesale and retail supplier of telecommunications services. Importantly, it also owns two of the three major local access networks outside the CBDs of major capital cities: the copper network that connects virtually every household in Australia; and the largest HFC network which passes around 2.5 million homes.

As the OECD outlined in 2001:

'An integrated firm, in contrast to a separated firm, benefits from any action which delays the provision of, raises the price or lowers the quality of access. An integrated

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<sup>3</sup> Robert Gottliebsen, 'Please Note: How Telstra could be done', *The Australian*, 7 November 2003, p23.

firm will therefore use whatever regulatory, legal, political or economic mechanism in its power to delay, restrict the quality or raise the price of access. Furthermore, the integrated firm has strong incentives to innovate in this area, constantly developing new techniques for delaying access. Although the regulator can address these techniques as they arise, it is likely to always be “catching up” with the incumbent firm. Regulation, despite its best efforts, is unlikely to be able to completely offset the advantage of the incumbent’.<sup>4</sup>

These comments have obvious application in the Australian market.

The Commission does not expect that alternative technologies offering new infrastructure platforms will significantly diminish Telstra’s near monopoly of copper local access in the foreseeable future.

Past proposals for widespread unwired local access have either been abandoned or are proceeding very slowly.

The take-up of the unconditioned local loop service by access seekers has been minor since its availability at the end of 2000.

The existence of such extensive market power in a vertically integrated firm is a major risk to competitive outcomes. Telstra has both the ability and, importantly, the incentive to frustrate entry into complementary and substitute markets by other companies.

The Commission is concerned that Telstra will be able to leverage market power into emerging markets. For example it could use its advantage in telephony and pay TV markets to restrict competition in mobile services.

This concern was also central to the Commission’s decision in 2000 to obtain a written assurance from Telstra that it would launch a wholesale ADSL service and an Unconditioned Local Loop service simultaneously with its deployment of a retail service. Some recent commentary has sought to explain the comparatively low

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<sup>4</sup> OECD, *Restructuring Public Utilities for Competition*, OECD, Paris, 2001, p.17.

current level of broadband rollout in Australia as being due in part to the obtaining of this commitment. Whilst these arguments fail to explore a whole range of other factors relevant to broadband uptake they also fail to acknowledge the potential detrimental competitive outcomes of an incumbent obtaining a significant first mover advantage by rolling out a retail ADSL product without providing competitive alternatives.

Telstra's dual ownership of infrastructure results in Telstra being largely unconstrained by the existence of competitors, particularly in relation to residential consumers where Telstra clearly dominates the customer access networks.

The Commission revealed in our most recent telecommunications infrastructure report<sup>5</sup> that around \$1.8 billion was invested in the local access network. Telstra accounted for the majority of this amount in 2001-02.

We also showed that new carriers were yet to make significant inroads into eroding Telstra's subscriber base which accounted for 85 per cent of subscriber connections across all local access network types at the end of June 2002. Collectively, Telstra and SingTel Optus held approximately 99 per cent of all local access network connections in Australia.

Future technological developments (that is, the digitisation of the copper network and HFC) have the potential to deliver new or improved services and could revolutionise home entertainment and provide significant efficiencies to business.

But there is a risk that Australia will reap the benefits of competition in telecommunications markets more slowly than other countries under the current regime. And even worse, competition may actually decline with digitisation should Telstra use its market power in existing markets to leverage into new markets.

What therefore can be done?

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<sup>5</sup> Australian Competition and Consumer Commission, *Telecommunications Infrastructure in Australia 2002*, October 2003. The report is based on survey responses from 52 carriers operating in the Australian market during 2001-02,



Both access regulation and conduct regulation, which prohibits anti-competitive conduct, have an important role in promoting competitive markets. When considered in isolation, Australia's access regime is fairly robust.

However, given the market power of Telstra, it is unlikely that any access regime would – on its own – deliver fully competitive outcomes.

Access arrangements, independent of structural separation, 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.

The Commission has put forward its views on possible solutions to these issues. In our *Emerging Market Structures* report to Government we proposed a number of structural access and regulatory reforms. Now, I don't propose to go into the detail of this recommendation here. The Government - and other interested parties - are now considering the report. Changes to policy will no doubt be developed by those involved in policy.

## **CURRENT WORK**

I now turn to the questions of how we improve information to the market and make regulation more transparent, how we regulate mobile services, how we determine access to pay TV services.

### ***Market Information and Transparency***

As part of its amendments to the telecommunications regime in December 2002, the Government sought to improve the standard and quality of information made available to the market.

The Minister for Communications gave Direction to the Commission in June this year that an accounting separation regime be implemented for Telstra.

Telstra's first reports are due to the Commission in three days. All indications are that we will deliver our first reports to the Minister at the end of December.

The initial rules, however, are a transitional phase. Telstra has been put on notice that it is expected to upgrade its information gathering systems to improve the amount and quality of information.

In June, the Minister also directed that six monthly reports on competition in corporate telecommunications markets be provided by the Commission. We will release a discussion paper in the next few weeks seeking comment on this project .

### ***Model Terms and Conditions***

The December 2002 amendments require that the Commission make a written determination setting out model terms and conditions, including prices, for access to core telecommunications service. These services are defined as the Public Switched Telephone Network Originating and Terminating Access Service; the Unconditioned Local Loop Service, and the Local Carriage Service.

The principal purpose of the model terms and conditions is to make public the Commission's views on what constitute fair terms and conditions of access to these services. The publication of these views should encourage parties to reach commercial agreement on access or consider submitting an access undertaking.

The Commission issued final determinations on 24 October 2003.

In general, the Commission's model prices not only involve reductions to access prices from prevailing levels, but the rates are significantly lower than those proposed by Telstra in its access undertakings submitted to the Commission earlier this year.

I am pleased to say that Telstra has now responded to the Commission's final determination by lodging a new set of access undertakings for each of the core declared services covered by the Commission's determination.

Telstra's new proposed access prices appear to be consistent with the Commission's views on the pricing of each of the core services I outlined earlier. This means if the Commission accepts these revised undertakings, access prices will mostly fall appreciably over the next three years and distortions such as the ADC will be progressively removed.

The Commission is now considering these new revised undertakings. We want to promote the long-term interests of end users.

Should we accept these undertakings it would represent a most significant milestone for the industry with a price ceiling being established for access to Telstra's fixed network over the next three years.

This would promote certainty around network and wholesale pricing and reduce the number of disputes and the level of litigation.

In proposing a new set of undertakings, Telstra has withdrawn its earlier 2003 access undertakings for these services which were lodged in January this year and which proposed prices considerably higher than those which are now in prospect.

In the absence of unexpected developments, we anticipate consulting on these revised undertakings between now and Christmas and expect to release our considered views by the first quarter of calendar 2004.

Our expectation is that recommendations will lead to more competitive retail offerings and lower prices for consumers.

In formulating non-price terms and conditions the Commission consulted widely with industry. We identified key issues as including:

- The terms and conditions of access to information systems
- Service migration
- Creditworthiness, and
- Ordering and provisioning.

The Commission has developed an 'in-principle' position and has drafted model clauses to address each of the concerns raised by industry participants. I do not want to go into our reasoning here. However, for the diligent, the results of our thinking can be found at [www.accc.gov.au](http://www.accc.gov.au). I will only say that we attempted to strike a balance between the legitimate interests of providers and the rights of those seeking access to the declared services.

### ***Regulating Mobile Services***

Over the past few years, the Commission has regularly examined the issue of mobile services. To accelerate the process whereby arbitrations were made about the mobile termination service, we released benchmarks for retail pricing in July 2001.

At the time, this was considered to be a novel approach. And so, we indicated that we would review the success of the methodology after two years. We also decided that we should conduct a broader review of the issues associated with mobile telephony.

As was expected, the approach to regulating the pricing of mobile termination has been a dominant feature of submissions to the review and discussion in public fora. The matter most often raised has been fixed-to-mobile (F2M) 'pass through'.

Participation by the industry in this process has been extensive. The Commission has received submissions in response to its discussion paper, and industry participated at two public forums that the Commission held on these issues.

The Commission is finalising its position on these complex issues.

Our goal in conducting the broader review of mobile services - which commenced in April 2003 - is to consider whether or not the regulation of certain mobile services is still appropriate under the Act and, if so, what form such regulation should take. The services covered in the review are mobile termination; mobile origination; domestic roaming; international roaming and 3G services. At present, the regulation of mobile services is largely focussed on mobile origination and termination services – thus ensuring 'any-to-any' connectivity.

### ***Pay TV***

Access to the existing analogue cable network has been a contentious matter for the Commission since at least 1999, when the current service was declared for access. This declaration provoked two separate disputes, which were notified to the Commission in 1999 and 2000. These were to be resolved with final determinations when Foxtel, Optus and Telstra subsequently proposed new content sharing arrangements.

The Commission accepted the content sharing agreements and related 87B undertakings in late 2002, but noted that the related access undertakings for both analogue and digital needed to be scrutinised further under Part XIC.

Accordingly, Telstra and Foxtel sought anticipatory exemptions, which would exempt the digital network from any future access obligations under Part XIC if it was to be declared by the Commission.

The Commission has now released its draft views on each of the analogue and digital applications. On the issue of analogue undertakings, the Commission decided that, in their present form, the undertakings cannot be approved. However, if certain changes are made to the pricing and non-pricing aspects, the undertakings could be considered and approved relatively quickly. On digital exemption proposals, the Commission proposed that the exemptions be approved on the condition that the parties made certain changes to undertakings about digital access. A final decision is imminent.

### ***Consumer Protection***

And finally I would like to turn to the subject of consumer protection.

The Commission received over 53,000 consumer complaints in 2002-03. Telecommunications registered around eight per cent of total claims. The industry was the leading target of complaints and this is not a desirable or satisfactory state of affairs.

The key challenge for the Commission in its consumer protection work is striking the right balance between enforcement and compliance.

The Commission would much prefer to see the Act complied with – this is clearly preferable to chasing unlawful conduct with remedies and court action.

However, despite our best endeavours, and those of the courts, there will be those who perpetrate serious breaches of the law. In these cases the Commission will not hesitate to take enforcement action.

While strong enforcement action can encourage compliance, we need to ensure that this does not lead to a tick-a-box approach, but becomes ingrained in the culture of an organisation.

Without question, the role of the CEO and Directors in any company is pivotal to this relationship. Some CEOs view compliance with the Act and a strong collaborative working relationship with the Commission as an essential part of normal business practice.

Other CEOs have developed a confrontational style focussing on media tirades against the Commission. Whilst those public tirades may superficially establish the CEO as the ‘defender’ or ‘hero’ of the organisation, they tend to breed a culture of confrontation and non-compliance.

I would like to point out they do not influence one way or another the Commission’s approach to enforcing the Act.

I am encouraging the Commission’s staff to recognise strong and effective compliance cultures in businesses. And I am spending some time talking to CEOs to try and explain and emphasise that the organisational culture in a business must be attuned to compliance.

## **CONCLUSION**

Over the past twelve months the Commission has focused on current technological developments and the changing regulatory environment.

Like all good regulators, the Commission's eye is on developments in other markets and jurisdictions. We note with interest the current debate in United States over regulatory arrangements for voice-over IP services.

The world never stands still in telecommunications.

The ongoing digitisation of networks is likely to continue, both as the cost of fibre drops and as demand for more bandwidth continues to increase. New carriage models will continue to emerge.

There will continue to be challenges, both for policy makers and regulators, in ensuring a competitive landscape.

I have identified for you today a range of issues.

My message is that the effectiveness of the regulatory regime in this country depends on the extent of competition. And that less regulation can be generated by more competition.

As markets change and new structures emerge, our challenge is to make sure that market power in existing markets is not leveraged into these new and developing markets.