Attention: Telecommunications writers

Launch of the Telecommunications Law Centre's second edition of *Australian Telecommunications Regulation*

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1. Introduction

This is a timely launch for a book on telecommunications – especially given the continuing strong public interest in the state of competition in this dynamic industry.

In recent times, pace of change and growth of sector has been very rapid – strong growth rate of 6.4 per cent (for 2000-01), following on from 12.3 per cent in year ending March 2001

- although it has slowed notably in recent months;
- down 2.7 per cent in June quarter – first time in ten years.

The worldwide downturn in the communications sector has led to extensive job shedding and rationalisation on both the international and domestic front presenting real challenges for companies and for regulators around the world.

2. Australian Telecommunications Regulation

As outlined in the publication being launched today, *Australian Telecommunications Regulation, 2nd edition,* the competition aspects of the telecommunications regulatory framework are now firmly embedded within the *Trade Practices Act*.

I want to emphasise the importance of publication of this type – the overview and detail helps to prevent debate being captured by special interests

- it a credit to the editors Alasdair Grant and Jock Given – they have worked mightily and David Howarth and David Stuart – former excellent officers of the Commission itself;
- it is particularly thorough – everyone would acknowledge telecommunications regulation is complex and highly technical;

- the history of the telecommunications industry in the policy context is a good demonstration of how far we have come;
- it does a very good job in comparing and contrasting the 1991/1997 Acts;
- it is clear that Alasdair and Jock consulted with the key stakeholders; and
- have gone to the heart of some of the complex definitional areas such as:
  1. whether ISPs are both content and carriage service providers; and
  2. whether content service providers should be subject only to the general provisions of Act.
- because it's written in a very objective manner – it's going to be an important reference tool to policy makers, analysts and industry participants.

3. Structural issues in telecommunications

I want to canvass a few broader issues.

The marriage between generic competition provisions and the telecommunications competition specific provisions occurred in 1997, and there is near universal acceptance of this arrangement

- for example, it is supported by the Productivity Commission's Draft Report into the Telecommunications Competition Specific Regulation (Final Report is yet to be publicly released by the Government).

The telecommunications legislative framework is largely service-based in nature - it effectively sets out a process by which we decide *what* to regulate and then *how* to regulate.

This means that regulation currently occurs *without* any reference to the structure of the industry *to begin with*

- perhaps we need to be consider how we regulate the telecommunications industry from the perspective of industry structure, rather than access alone
- and that our regulatory reference point could be the market power of the incumbent.

For vast majority of industries covered by *Trade Practices Act*, efficiency levels were developed over time in a largely private sector environment

- this is certainly not the case for Telstra, which began its life a publicly owned provider
- Telstra was corporatised in 1991; and has been subject to competition, albeit of a limited form, from new entrants since 1997.

Different models of regulation

Other jurisdictions have taken a considered look at regulated industries and advocated another way forward.

In April 2001 the OECD released a paper regarding structural separation in regulated industries.

The OECD found that, in telecommunications, activities that are usually non-competitive include both:

- the provision of a ubiquitous network; and
- local residential telephony in rural areas.

In addition, the OECD identified activities that are potentially competitive include:

- long-distance services;
- mobile services;
- value-added services;
- local loop services to high volume business customers, especially in high density areas; and
- local loop services in areas served by broadband (eg cable TV) networks.[1]

This description largely fits the Australian telecommunications industry

- although in Australia we have a relatively unique situation whereby the owner of the local loop is also a fifty per cent shareholder in the major pay television cable network.

The combination of vertical integration of carriage services with the ownership of strategic content provides Telstra with unparalleled market power in the domestic market. Clearly, this has significant implications for competition in both price and services.

Turning now to how things can be improved.

The OECD outlined the following models for protecting and promoting competition.

Where the regulator intervenes to fix the terms and conditions at which rival firms in the competitive component acquire access to the non-competitive services. A number of different alternatives present themselves:

1. Access regulation

Where the regulator intervenes to fix the terms and conditions at which rival firms in the competitive component acquire access to the non-competitive services (that is, Part XIC of the *Trade Practices Act*).

Other approaches, which involve various models of separation include:

2. Ownership separation

This is the vertical separation of the non-competitive activity and the competitive activity, protected by line-of-business restraints or other controls on integration.

3. Club ownership

Joint ownership of the non-competitive activity by firms in the competitive component.

4. Operational separation

Non-competitive components are placed under the control of an independent entity.

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[1] Organisation for Economic Co-operation and Development (OECD), *Structural Separation in Regulated Industries* (Directorate for Financial, Fiscal and Enterprise Affairs Committee on Competition Law and Policy, 2001, p.4).

5. Separation into reciprocal or smaller parts

Separation of the non-competitive components into smaller reciprocal parts to counter the demand-side economies of scale (that is, consumers are prepared to pay more to be connected to a network on which they can contact more people).

6. Accounting, functional and corporate separation

Separation of different accounts, functional divisions and corporate entities although owned by the same company – to some degree, Australia has adopted this approach by introducing a Regulatory Accounting Framework.

The primary advantage of structural separation is described by the OECD as limiting:

> *…the need for regulation that is difficult, costly and only partially effective…it reduces the incentive of the provider of the non-competitive activity to restrict competition in the competitive activity.*[2]

The OECD also outlined the quality of regulatory processes themselves under a regime in which structural separation has *not* occurred:

> *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 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.*[3]

This may sound familiar. The Chairman of Telstra, Mr Bob Mansfield, recently told Telstra's shareholders at its AGM:

> *The right to appeal is the basic principle that holds the present system together, creating incentives to commercially negotiate. Other carriers were no doubt encouraged to negotiate by the Government's proper lack of support to abolish or water down appeal rights. Without appeals there would be little incentive for those seeking access to negotiate.*[4]

This could be interpreted in two ways.

- First, the way in which Telstra has interpreted merit review is as 'the basic principle' for creating incentives to negotiate
- Second, that the retention of a merit review process has led to commercial access rates being higher than those which the ACCC sees as efficient. Furthermore, that the threat of a lengthy tribunal process effectively gives Telstra the ability to leverage the price of access rights against the access seeker's strong need for certainty.

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2 *Ibid*, p.16.

3 *Ibid*, p.17.

4 Bob Mansfield, Telstra Annual General Meeting, 16 November 2001, http://www.telstra.com.au/newsroom/speech.cfm?Speech=17341, accessed 19 November 2001.

Telstra's deliberate strategy of using regulatory delay as a tactic was recently referred to by Telstra's group managing director, Wholesale, Media, Legal and Regulatory, Mr Bruce Akhurst:

> *We have moved from just under 40 disputes to just under 10...I am not interested in taking a confrontational or legalistic approach.* ***We have done that for years*** *[emphasis added]. Now is a real opportunity to take a commercial approach...We are really trying to grow the retail market by providing great solutions to the wholesale market...My focus will be on the commercial resolution of outcomes and customer service.*[5]

There is no doubt in my mind that Telstra's incumbency and strong degree of vertical integration gives it an unparalleled advantage in the Australian market.

At Telstra's most recent Annual General Meeting (noted above), Telstra outlined its performance to be superior to its international and domestic peers.

- the Commission recently engaged Ovum to conduct a study which concluded that Telstra compared favourably with SingTel and TNZ. SingTel's performance overall appears the strongest of the three – in Ovum's view, this reflected the level of SingTel's dominance in its home market, which has only recently been deregulated.
- analysis also found that Telstra's return has been diminished by its (non-regulated) domestic and overseas investments, with write-downs of over a billion dollars recorded.

Additionally, a recent Macquarie Research Equities publication found that:

> *Overall, Telstra was most frequently the most expensive provider with its offerings for residential telephony service, broadband and dial-up Internet usage and ISDN service all being ranked behind both Telecom NZ and SingTel in the respective home markets.*[6]

It is clear from the work of the OECD that the competitive environment is significantly influenced by the extent to which the incumbent is fully integrated. The circumstances of the Australian telecommunications market are such that the fully integrated incumbent wields substantial market power.

Any regulatory environment therefore needs to be fully cognisant, and take full account of such market power.

In particular, to regulate properly, and in the national interest, a full set of regulatory tools would be required

The OECD has described the success of access regulation – that is, what we currently have at our disposal in Australia - as being dependent upon the regulator's resources, information and instruments of control.

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5 Exchange, vol 13, no 45, 3rd Wave Communication Pty Ltd, 23 November 2001, p.3.

6 Macquarie Research Equities, *Call Forward*, Vol 77 (2001, p.5)

Given the fully integrated nature of the incumbent, in the absence of structural change, it becomes even more important for the existing access-based regulatory regime to be made more effective by:

- the introduction of a compulsory undertakings power;
- the development of conduct standards; and
- changing the current flawed process of negotiation, arbitration, and re-arbitration.