

Competitive  
Carriers'  
Coalition

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31 May 2004

**Submission to the Productivity Commission Review of  
National Competition Policy Arrangements**

## **Introduction**

The Competitive Carriers Coalition is pleased to be able to contribute to this Productivity Commission inquiry. This submission is intended as an overview and introduction to the issues that the CCC believes make the state of competition in Australian telecommunications markets an area of the economy that requires urgent attention and policy reform. This submission is not intended to be comprehensive, but to point to the great weight of prior research and advocacy in this area. The CCC would welcome the opportunity to expand on any of the issues or areas of discussion in this submission if the Commission believe that it might be of further assistance.

The CCC is an alliance of five non-incumbent carriers operating in the fixed line voice, data services, Internet, and mobile voice and data markets in Australia. Collectively, the group has invested in the order of \$4 billion in new telecommunications infrastructure in Australia. This includes some of the most advanced fixed line and mobile network technology in the world.

The CCC members compete with each other in various markets, but are united by a belief in competition and by their commitment to advancing and enhancing the competitive environment in telecommunications in Australia, particularly facilities-based competition. The CCC members believe that international and Australian experience has demonstrated that competition in communications market can only be sustainably achieved if it is infrastructure-based competition. The CCC members believe that their substantial investment commitments place them in a strong position to reflect on the weaknesses of the present environment.

The CCC submits that the case for the development and implementation of a set of regulatory reforms targeting structural impediments to competition is unarguable. There are two broad reasons that such action is now imperative – the demonstrated failure of the present regulatory arrangements to result in effective competition, and the evolution of communications technologies over the past 20 years that requires, in the view of regulators in other jurisdictions, a revisiting of the fundamental principles underpinning the regulatory environment.

The CCC is aware that its arguments for structural reform to support competition in telecommunications have often been dismissed by Telstra on the grounds that the members of the CCC have a vested interest in weakening Telstra's competitive position. Such responses do not address the fundamental arguments of the CCC, but the CCC would urge the Productivity Commission to be mindful of the wide range of authoritative sources relied upon in this submission and the reading list attached to it when assessing these claims and the weight of the CCC case. Of particular importance, we submit, are the published opinions and recommendations of the competition regulators, the ACCC and the NCC, and of the independent economic consultants referred to below, who have

been united in arguing for the need for fundamental pro-competition reform of the structure of the telecommunications environment.

More generally, the CCC believes there are two reasons that the Productivity Commission should consider telecommunications as an area requiring high priority attention for the purposes of this inquiry.

1. Telecommunications competition reform is “unfinished business” because the Federal Government has not conducted sufficiently wide-ranging inquiries into the structure of the industry to satisfy its obligations under the NCP, and;
2. The potential benefits to the Australian economy from further competition reform in telecommunications are significant. The CCC would go so far as to say that, because communications represents core enabling technologies for almost all businesses, the need to maximize Australia’s international competitiveness requires that communications be a high priority for policy action.

### **Unfinished Business – The NCC view of Commonwealth Responsibilities to Review Structural Issues**

The CCC believes that communications represents one of the most significant areas – if not the most significant area – of unfinished business in the national competition policy agenda. The CCC believes that this is the case both in terms of;

1. the specific obligations on the Commonwealth Government to review its legislation to ensure compliance with NCP, and;
2. the national economic benefit that remains to be realized by taking further action to increase competition in communications markets.

The CCC believes that the first of these falls within the categories of the key elements of the NCP, as described on page 2 of the PC Issues Paper. It includes the specific access arrangements introduced in communications markets and the effectiveness of sanctions for anti-competitive conduct associated with them, and the requirement on the Commonwealth to consider the need for structural reform.

The second point relates to the Commission’s comments that the report will also incorporate the wider ambition of the NCP reforms, which it says “are predicated on improving the competitiveness and flexibility of the Australian economy in a way which also meets ‘public interest’ considerations”. The broader impacts of the Commonwealth failure to initiate structural reforms to enhance competition are discussed in greater detail later in this paper.

There are specific obligations on the Commonwealth under the NCP that the CCC believes have not been satisfied. The CCC bases this view on the published comments of the National Competition Council.

The NCC has commented on the obligations of the Commonwealth that arose from its decision to partially privatize Telstra in 1997, and in 1999. The NCC has said that the Commonwealth has a responsibility under clause 4 of the Competition Policy Agreement to ensure that the regulatory regime and *Telstra's structure and commercial objectives* facilitate competitive outcomes consistent with the public interest.

NCC commented in a submission to a House of Representatives inquiry into Structural Separation (an inquiry cancelled without reporting) that:

“Sub-clause 4(3) (of the CPA) states that before a government ... privatizes a monopoly, it will review (amongst other things) ‘the merits of separating any natural monopoly elements from potentially competitive elements of the public monopoly’”.<sup>1</sup>

The NCC repeated its concerns about the need to review structural market issues in its 2003 assessment of progress toward implementing the NCP, where it referred to work it had commissioned from Tasman Asia Pacific into the effectiveness of record keeping rules in controlling anti-competitive behavior. That study found that these rules were a necessary first step to achieving broader ring fencing, but that even ring-fencing would not remove Telstra's incentive to behave anti-competitively.<sup>2</sup>

The NCC went on to conclude in its 2003 review that:<sup>3</sup>

“The Council remains of the view that achieving a competitive telecommunications industry capable of delivering substantial benefits to consumers may require the Government to further consider the structure of Telstra, including the option of the structural separation of the fixed network.”

The CCC believes that the strong implication in the comments from the NCP is that the Commonwealth has not satisfied its obligations under Section 4 of the CPA. Indeed, as the Productivity Commission would be well aware, the Government specifically excluded the issues related to structural separation from the terms of reference for an inquiry into competition in telecommunications it sent to the Productivity Commission in 2001.

### **The Case for the Failure of the Existing Arrangements – Competition Regulation is Inadequate**

CCC members have consistently argued that competition in the Australian telecommunications markets is patchy and, overall, inadequate. The evidence of the cost of these inadequacies is wide spread and ranges from rises in prices to consumers, to the

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<sup>1</sup> NCC Submission 25 to House of Representatives Standing Committee on Communications, IT and the Arts Inquiry into the Structure of Telstra 20 January 2003.

<sup>2</sup> Tasman Asia Pacific Accounting Separation of Local Fixed Network July 1999.

<sup>3</sup> Assessment of Governments Progress in Implementing the National Competition Policy and Related Reforms Volume 2 2003.

slow deployment of new technologies, to sub-optimal investment in competitive infrastructure and new technologies.

Evidence of the failure of competition has been offered from many market participants in various fora in recent years. However, the most persuasive evidence of the failure of competition comes from the body charged with regulating the telecommunications markets, the Australian Competition and Consumer Commission. The ACCC submits that the ACCC's independence from commercial interests and its intimate view on behaviour across a range of telecommunications markets places its credibility above question.

*The ACCC has repeatedly publicly stated that the regulatory regime has failed to deliver the level of competition envisaged when it was introduced. As a result, the need for regulation has increased rather than diminished, as was expected when the legislation to encourage fully competitive market structures was passed in 1997.*<sup>4</sup>

In the assessment of the ACCC, "progress is slowing in achieving effectively competitive telecommunications markets". (Telecommunications Reports 2001-02) The ACCC observed that competition was strongest where alternative and independently owned infrastructure existed.

The ACCC notes that this infrastructure was largely initiated and funded during the bull market for such investment, which ended in 2001. It is highly unlikely that such an enthusiasm for investing in infrastructure by new entrants will be seen on such a scale again in the foreseeable future. Evidence of slowing competitive pressure cited by the ACCC corresponds with the timing of this change in the investment environment.

It is clear both anecdotally and from the more detailed assessments of the ACCC that competition is failing in those areas where facilities or infrastructure-based competition is weakest. For example, the ACCC described local telecommunications services (including local calls and basic access lines) and fixed-to-mobile services as being "a long way" from effectively competitive. In national long distance and international calls, the ACCC saw competition developing well but noted that Telstra's network ownership "provides it with a seemingly impassable advantage over competitors" and appeared to be inflating prices to consumers.<sup>5</sup>

It is also clear from the ACCC assessments that the cost of this competitive weakness is being borne ultimately by consumers, both in the form of higher prices and less choice. For other participants in the telecommunications markets, the failure of competition is felt in the form of higher input costs, lower margins and less ability to raise funds for investment in deploying new technologies.

Regulation to promote telecommunications competition in Australia has, broadly, relied on the three elements:

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<sup>4</sup> *Report to the Minister on Emerging Market Structures in the Communications Sectors, and ACCC Telecommunications Reports 2001-02*

<sup>5</sup> *ACCC Telecommunications Reports 2001-02*

- Rules against anti-competitive conduct
- Regulating access to monopoly or bottleneck facilities and;
- Regulation and monitoring of prices and service levels for basic services.

The reasons for the failure of access regulation to deal effectively with Telstra's market power, as described by the ACCC, are discussed elsewhere in this document. The inadequacy of the price control and performance monitoring regimes overseen by the ACCC and the ACA must also be considered, however.

Again, Comindico points to recent comments by the regulator itself as evidence of the problems of relying on these mechanisms. In its 2001-02 Telecommunications Reports, the ACCC included a discussion on its concerns about the methodology Telstra had employed to report on its performance in meeting its obligations under the price cap arrangements. These price caps are crucial elements in the regulatory regime because they provide the first line safety net for consumers in the deregulated telecommunications markets.

Briefly, the ACCC offered the opinion in its 2001-02 Reports that Telstra had breached its price control obligations by choosing a methodology that the ACCC did not believe provided an accurate measure of price movements. Using its preferred methodology, Telstra reported a lower price increase for line rentals than the methodology that the ACCC employed to measure price movements for the same service.

Putting aside the particulars of this dispute, it demonstrates the difficulties that regulators have in assessing the behaviour of Telstra, let alone controlling it. *The requirements on Telstra to meet its price cap obligations are among the highest that it faces, as compliance with these provisions are a condition of its carrier licence. That it was willing to let a dispute with the regulator on an issue of such importance reach such a point of confrontation indicates the difficulties of regulating its behaviour in the present regime.*

Further, the continuing need for new, enhanced or extended regulation that policy-makers must rely upon in the absence of effective competition to protect consumers and encourage new services is itself harmful to competition. *High levels of regulation compliance costs present a barrier to entry for new entrants, and an advantage to a large, established, integrated operator such as Telstra.* Telstra is further able to leverage this advantage by participating in all of the fora in which regulation and legislation is developed, giving it both influence over the shape of the rules-based environment and an insight into the increasingly complex web of rules that few others in the industry can match.

The present chairman of the ACCC, Graeme Samuel, has continued to express the same views as his predecessor in relation to the structural problems plaguing the competitive environment in telecommunications. In November 2003 he said: "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.”<sup>6</sup>

Subsequent to these remarks, Telstra demonstrated precisely how true these remarks were when it introduced retail broadband prices that were below its wholesale prices, resulting in the ACCC invoking a competition notice against it under the Trade Practices Act. This notice remains in place at the time of writing. The CCC believes that this case study is of profound importance to illustrate the failures of the present arrangements. However, an adequate description of these events is beyond the scope of this summary. The CCC would be happy to provide the Commission with a detailed paper on these still unfolding events, if the Commission considers it of potential value.

In December 2002, the then Federal Communications Minister, Senator Richard Alston, responded to a growing concern about the impact of the structure of Telstra and its impact on competition in telecommunications by asking the House of Representatives Standing Committee on Communications, IT and the Arts to inquire into the structure of Telstra. This inquiry resulted in a large number of contributions from the public, the overwhelming majority of which were in support of structural separation, including several from highly respected economic consultants.

ACIL Tasman and Core Research were among many who argued in submissions to the House of Representatives inquiry that there was evidence of serious problems in the competitive environment in telecommunications and that a detailed inquiry into the issue and options for reform was necessary.

The Core Research (King & Gans) paper identifies a need for an inquiry into two aspects of present situation: the types of business entities that could be technically separated in an operational sense, and; how would different forms of structural separation impact on the telecommunications markets.<sup>7</sup>

ACIL Tasman\* argued that the telecommunications sector is being curtailed by insufficient competition resulting from Telstra’s dominance. It said a general review of regulatory measures was required and structural reform needed to be considered seriously.<sup>8</sup>

Despite these submissions, the House of Representatives inquiry was abandoned without reporting.

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<sup>6</sup> Graeme Samuel, ACCC Chairman, speech to Australian Financial Review Telecom Summit 27 November 2003

<sup>7</sup> Investigating the Benefits and Costs of the Structural Separation of Telstra. Core Research Submission to the House of Representatives Standing Committee on Communications, Information Technology and the Arts – Inquiry into the Structure of Telstra

<sup>8</sup> ACIL Tasman January 2003 Submission to the House of Representatives Standing Committee on Communications, Information Technology and the Arts – Inquiry into the Structure of Telstra

\* ACIL Tasman was commissioned by the CCC to consider the terms of reference of the inquiry.

## **Case for a Review of Market Regulation: The Lessons of Experience, Evolving Markets and Technological Changes**

Australia has, according to the ACCC, one of the highest levels of horizontal and vertical concentration in its communications industry of any country. Certainly, Australia stands out among OECD countries for Telstra's cross ownership of cable, PSTN, mobile, broadband delivery and content, directories and publishing interests.

Yet even with their lower concentration, jurisdictions around the world are initiating far-reaching reviews of their communications regulation regimes and examining the need for even more structural separation.

These initiatives appear to be driven by both an awareness that existing regimes have been in place for decades, and there are years of practical experience that have demonstrated weaknesses that, because of more recent technologies changes, have been exposed.

In the UK, the recently created combined communications and media regulator, Ofcom, has recently initiated a wide-ranging inquiry into the future regulation of communications. Ofcom has stated that it is necessary to return to first principles in considering how to regulate communications and has pointedly placed structural separation as one of the first order questions to be considered.

The UK has a vertically integrated incumbent telco, BT, but has a far less integrated total communications market than Australia. BT is excluded from the Pay TV market and voluntarily divested its mobile telephony business.

Even in these circumstances, Ofcom is concerned that structural separation must be re-examined.<sup>9</sup>

This is because it argues that the existing competition regime is a legacy of the thinking that was current in the 1980s about the best ways of creating a competitive telecommunications market. Like the Australian regime, it is based on the principle of providing access to market entrants, not managing a situation where there are other participants in the market seeking to expand.

The ACCC, as discussed above, has stated that the access regime in Australia is inadequate for dealing with the fundamental incentives of Telstra to favor its own retail businesses over competitors.

The complication, delay and compromise that has marked the process of establishing access prices to bottleneck facilities in Australia illustrates powerfully the difficulty of coming terms with this problem through an access regime alone.

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<sup>9</sup> Ofcom: Strategic Review of Telecommunications: Phase 1 Consultation Document



Core Research discussed why only a true marginal cost wholesale access price can support a genuinely sustainable competitive environment where there is an integrated incumbent in its paper on interconnection pricing of June 2003<sup>10</sup>. Yet after seven years, the price of access to core services such as the PSTN access network remain the subject of controversy and dispute between the ACCC, Telstra and other carriers. For example, in its indicative price decision last year, the ACCC finally concluded that there was so-called no access deficit, yet accepted that Telstra should have a period of years to phase out this unjustifiable cost impost.

While argument for access to these services has continued for seven years, debates for access to new technologies have emerged along with those technologies. Again, the evidence of competitive failure and the inability of the competitive regime to deal with it have been illustrated by the recent dispute in the ADSL wholesale market.<sup>11</sup>

The UK Competitive Telecommunications Association has argued the instruments of regulation must evolve because the behaviour of incumbents moves through phases. It argues that the major issues for regulation when competition is first introduced are “the inefficiencies in prices, with prices and costs not being aligned”.

“During this phase of regulation fairly blunt regulatory tools, such as retail price caps, are typically sufficient for the task, though at the same time the basic infrastructure for facilitating the development of competition, such as regulated interconnection charges, is introduced. However, as competition increases, this form of regulation must necessarily begin to give way to a second phase where the emphasis is on sustainable competition.”<sup>12</sup>

The UKCTA says that the core problem in this phase is one of discrimination against access seekers.

The CCC contends that the regulatory regime in Australia reflects precisely these characteristics – it was designed to let new entrants gain a “foot hold” in the market, on the assumption that they would invest increasingly in their own infrastructure, and that this would over time reduce Telstra’s power to control the market. However, experience has shown that the combination of the increasingly subtle exercise of market power and the reduced availability of capital have not led to the market evolving in the way envisaged a decade ago.

Indeed, the experience of the members of the CCC suggests that investment in unique infrastructure does little to liberate them from Telstra’s ability to manipulate market outcomes, while raising Telstra’s awareness of them to the extent that it targets them even more directly in the market. Certainly, the course of the ADSL price squeeze dispute has led the members of the CCC to conclude that Telstra is offering restructured

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<sup>10</sup> Core Research: Competitive Neutrality in Interconnection Pricing, June 2003.

<sup>11</sup> CCC supplementary submission to Senate Broadband Inquiry

<sup>12</sup> UKCTA: From the Market Reviews to a Model of Transactional Transparency. September 2003

wholesale pricing options that effectively corral other market participants into retail business plans that reflect Telstra's preferred model of market development.

Apart from the evolution in the competitive environment since the first steps were taken to move away from public monopolies in telecommunications, there have been great technological shifts that the regulatory regimes were not designed to handle. Ofcom points to the growth of mobile communications, higher bandwidth services, data and Internet and voice over IP as just some examples.

In the US, technological change is also resulting in reviews of some of the fundamental definitions of regulation. There have been a series of rulings and statements with regard to the status of voice over Internet Protocol services and technologies under existing regulations. In February 2004, the Federal Communications Commission issued a Notice of Proposed Rulemaking to examine the issues surrounding new voice delivery technologies. FCC chairman Michael Powell has said that the Commission is seeking to resolve issues around the taxes and interconnection charging regimes, and "keeping a watchful eye for anti-competitive conduct by owners of broadband networks to ensure our citizens can tap the full potential of the Internet in a broadband world".<sup>13</sup>

Again, it bears emphasis that the structural reform of the telecommunications in the US, like the UK, is far in advance of that in Australia (beginning with the structural separation of AT&T in the 1970 and 1980s) yet there is a belief that a new generation of competition-related regulatory challenges require investigation.

### **Where To From Here – Possible Remedies**

The majority of Telstra's competitors are strongly of the view that only structural remedies can address Telstra's market power.

The members of the CCC, collectively and individually, have advocated structural separation. As a minimum, they have called for the urgent introduction of a divestiture power into the Trade Practices Act. This would be a companion to the mergers powers of the ACCC. It would allow the ACCC to apply to the Federal Court to order a company to divest itself of elements of its business that gave rise to unacceptable levels of market power.

Even among competitors who have not supported structural separation there is an acceptance that structural problems are at the heart of competitive failure and market underperformance by Telstra, and that there is a need for some parts of the Telstra business to be spun off. For example, the recently retired CEO of Optus, Chris Anderson, said this year:

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<sup>13</sup> Michael Powell, Chairman Federal Communications Commission: Written statement to Committee on Commerce, Science, and Transportation United States Senate February 24, 2004

“... The only thing I'd say about Telstra is that they do have enormous cashflows and enormous power and my worry in Australia is that Telstra uses that predatory power, and I don't think the consumers or the businesses of Australia necessarily benefit.

“However, when you're looking at now, there is a split of businesses, I think there maybe a model in the future where in fact Foxtel goes off somewhere else, where Sensis goes off somewhere else, and we're the core network's perhaps left in public ownership because at the moment it is a little in no-man's land.”<sup>14</sup>

There are numerous models of structural separation that could be employed, and numerous options for associated policy measures: Some of the most commonly discussed options are:

1. divestiture power
2. separation of Telstra retail and wholesale businesses
3. separation of core network assets in stand alone business/businesses
4. disaggregation of access network from transmission and services and content i.e vertical and horizontal separation

It is beyond the scope of this submission to recommend which of these is the best option. However, it is clear that a full examination of those issues is beyond due.

### **Winners and Losers – Benefits and Costs of Reform**

The impact of structural reform will of course be a function of the type of reform being proposed. However, there have been arguments against structural separation of any type that have rested on the general proposition that classes of “losers” can be identified in advance of any detailed proposal. The CCC submits that this is not a sensible argument, and that the even in the absence of detailed reform proposals, there is evidence that “losers” identified could benefit from structural separation.

For example, it has been argued that the impact on shareholders in Telstra is a barrier to its structural separation. This appears to be based on the contention that they would suffered reduced share value.

Analysis commissioned by the CCC from ACIL Tasman suggested that this is not necessarily the case, based on case studies in other industries and a telco in another market. Indeed in other industries is strong pressure for business to disaggregate to release shareholder wealth.

Recent Australian examples of this include WMC and BHP Billiton. In telecommunications, the UK has seen BT spin off mobiles to release shareholder value.

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<sup>14</sup> Chris Anderson Business Sunday Interview May 9 2004.

This suggests that so-called synergy factors referred to by supporters of structural integration are weak or not readily apparent in other industries or in telcos in other markets. Therefore, to be true that there would be a substantial diminution of shareholder wealth from structurally separating Telstra would tend to imply that Telstra enjoys some form market price premium based on the belief that it enjoys monopoly rents due to its integration. If this is so, the public policy priority must surely be to place the national economic interest and consistency with stated policy objectives ahead of the interests of shareholders.

Another argument related to public policy is that the Government's intention to privatize Telstra to achieve a reduction in debt and better budgetary outcome militates against taking any action to delay or confuse privatization, or to reduce the value of the business. The question of the impact of structural reform on the value of the business is related to the above discussion about shareholder impacts, and therefore obviously highly contestable.

The other elements of this case for taking no action on structural competition reform are also questionable for several reasons.

Firstly, the proposals for the sale of Telstra have not been compelling enough to pass the Senate, in part because the Democrats and other have expressed concerns about the competitive framework.

Secondly, is questionable whether the contribution to the budget of privatizing Telstra in its present form would be positive.

The case that the Government has consistently made in favor of privatization in relation to the national fiscal position has been built on the importance of reduction public sector debt, and the strain that this places on the budget and interest rates.

Access Economics, in a report commissioned by the CCC, has argued that the impact on the budget of privatization is a more complicated equation, and that the impact of a more efficient telecommunications sector on national economic output is a factor that must be taken into account.<sup>15</sup>

Further, it argues that the impact of the sale in the budget would be expresses through retirement of debt reducing Public Debt Interest payments in the budget and through decreased dividends payments. It suggests that the equation would be a finely balanced one, and ultimately the price at which the shares were sold would determine if it was positive or negative on balance.

However, Access also says that;

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<sup>15</sup> Access Economics Further Reform of the Australian Telecommunications Regulation and the Budgetary Impact of Privatisation of Telstra June 2002.

“The *only* logic, from an economy-wide perspective, for selling government assets is that they are thereby allowed to perform more efficiently. Privatisation is intended to remove institutional barriers to more efficient operations and lower costs, facilitating better performance and broader economic gains. Absent these benefits, selling or not selling Telstra is pretty much a zero-sum game from an economy wide perspective and from a longer term budgetary perspective as well.”

That suggests that the benefits from creating a more competitive and efficient telecommunications sector as a whole are likely to dwarf the impact of a sale on the budget over the longer term.

The CCC is aware that, more recently, there have been suggestions that the case for privatizing Telstra is that the proceeds could be used for “nation building” projects.

This obviously adds further to the complication of assessing the impact of privatization of Telstra on the Federal Budget. Money diverted from debt retirement would weigh against a positive impact; investment in productive assets would weight toward a positive impact.

From the above, the CCC contends that the argument that the Government’s intention to sell its remaining share in Telstra to effect a positive budget outcome militates against further pro-competition reform in telecommunications simply does not stand up to rigorous examination.

Finally, but most importantly, there is the question of the cost to the nation of a less than fully competitive telecommunications sector.

The CCC submits that a recent study conducted by the Allen Consulting Group, and Commissioned by Ericsson Australia, provides a valuable contribution to this discussion.

The study looked at the potential economic impact of a “true broadband”, fibre to the premises access network in a region of south-east Queensland. It also compared the outcome if that network were to be an open access network compared to one integrated with an upstream network owner.

The result was a delta of \$720 million in increased GSP over a period of 15 years between the open access model and the integrated model (\$4180m additional GSP growth under a vertically integrated model compared to \$4900m in an open access model).

It is further important to note that the model was conservative in that it modeled only one variable between the two ownership structures – the speed of uptake by consumers. The model anticipated that if more providers were competing to deliver services on the network, this would drive quicker consumer uptake.

In reality, it is likely that the benefits of competition would be multifaceted. For example, it is likely that the development of new services would accelerate if the businesses developing those services had fair market access. This is seen in the more advanced

deployment of Voice Over Internet Protocol voice services in the US and the UK, compared to Australia where such services are only now beginning to receive attention.

### **Structure of Regulators and New Remedies**

One of the structural issues that the on-going dilemma of inadequate competition in communications markets has highlighted is that the structure and powers of regulators is inadequate to deal with what the ACCC has referred to as the fundamental incentives of Telstra to discriminate against access seekers competing with its own retail operations.

As described above, the ACCC has recommended to the Federal Government that Telstra be required to divest itself of its interest in the Foxtel business and the HFC cable that carries that service. It has also recommended that the Federal Government investigate more broadly the whole issue of structural separation. The NCC has repeatedly reported that it believes that the Federal Government has an obligation under the NCP to inquire into structural separation as a result of its decision to privatize the company.

Yet the regulatory structure and available remedies are such that neither of these agencies appear able or willing to initiate such an inquiry, nor implement structural remedies.

As described above, the CCC believes that the ACCC should be, at a minimum, armed with a power to seek a court-ordered divestiture. This would be complementary to the mergers power that allows it to prevent the creation of monopolies by giving it the ability to break up monopolies that already exist.

It would also be similar to the situation in the US, where anti-trust legislation was used to break the telecommunications incumbent there into functional and geographically separate and competing businesses.

However, the ACCC should also be encouraged to conduct detail inquiries into competitive environments where it suspects that there is inadequate competition. The ACCC's inquiry into emerging market was initiated after a specific request from the then Minister, who summarily dismissed the findings and recommendations of the report.

Likewise, the NCC has the ability to recommend that competition payments are withheld from states that do not meet their obligations under the NCP, but seemingly has no leverage to require a response from the Federal Government when it believes that government has failed to meet its obligations.

The parallel roles of these organizations have starkly exposed the problem of competition in communications markets. It is an open question as to whether there is need to consider their future structure as part of a process of introducing a set of structural competition remedies.

One failsafe mechanism against regulatory role confusion or conservatism that the CCC believes should be imported from other jurisdictions, such as the US, is to make a feature of a divestiture remedy the ability for third parties to initiate divestiture action in the courts. The commercial reality is that the complication and expense of taking such a private action would represent an enormous hurdle and discourage vexatious actions. On the other hand, its existence as a last resort would provide a powerful incentive against incumbents tempted to exploit market power and in favor of regulators assessing thoroughly the case for them to initiate a divestiture action.

## **Conclusion**

The following passage from the ACCC provides a succinct summary of the urgent need for action to drive a new wave of competition in the communications markets in Australia.

“The Commission’s analysis indicates that the progress of competition in telecommunications markets is slowing. To date, the types of benefits that have arisen from the introduction of competition in telecommunications markets have largely flowed from competition at the retail level of the market as opposed to competition between telecommunications infrastructure providers (the wholesale level of the market).

“The incumbent, Telstra, remains a dominant firm in telecommunications. It is one of the most integrated communications companies in the world, continuing to be the major wholesale and retail supplier of telecommunications services, including:

- local, national, long-distance, international and mobile voice
- dial-up and broadband internet
- data
- printed and online directories
- pay TV (through its 50% ownership interest in Foxtel)

The extent of Telstra’s dominance of the sector is demonstrated by the fact it receives almost 60 percent of total industry revenue, which is almost four times the revenue its closest rival, Optus, receives. It is reported to receive over 90 percent of industry profits.”<sup>16</sup>

The CCC and its member companies invite the Productivity Commission to contact us for any further information, clarification or amplification of the issues raised in this submission. We hope that the present inquiry will see fit to give the issues the priority we submit they deserve.

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<sup>16</sup> ACCC Emerging Market Structures in the Communications Sector Report June 2003

## **Related Reading**

Core Research: Investigating the Benefits and Costs of the Structural Separation of Telstra.

Competitive Neutrality in Access Pricing January 2003

Access Economics

Further Reform of the Australian Telecommunications Regulation and the Budgetary Impact of Privatisation of Telstra June 2002.

ACIL Tasman: The Impact on Structural Change on Shareholder Value Oct 2003

Submission to the House of Representatives Standing Committee on Communications IT and the Arts January 2003.

Tasman Asia Pacific: Accounting Separation of Local Fixed Network July 1999

Allen Consulting: True Broadband: Exploring the Economic Impacts Sept 2003

Ofcom: Strategic Review of Telecommunications: Phase 1 Consultation Document