

**Competitive  
Carriers'  
Coalition Inc**

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**Response to the Productivity Commission Inquiry into  
NCP Discussion Draft**

**29 November 2004**

## **Introduction**

The CCC welcomes the recommendation in the Productivity Commission's discussion draft report into NCP that the structure of Telstra requires thorough investigation, particularly before further privatisation. It also supports the broader call from the Commission for a new national competition reform agenda.

In this submission, the CCC examines only two issues arising from the section of the draft report relating to telecommunications: the efficacy of accounting separation as a mechanism for dealing with the problems arising from the structure of Telstra, and; the potential contribution of further pro-competitive reform of telecommunications toward to the national economy.

In relation to the latter point, the CCC contends the potential for gains in national growth and productivity from telecommunications services are very large, and therefore that reform of telecommunications markets to enhance competition should be one of the highest priority items on the competition policy reform agenda.

This paper represents a summary of the views of the CCC. Attached are documents that expand on these issues from independent research and analysis consultancies.

## **The Role and Limits of Accounting Separation**

The CCC notes and supports the Commission's comments about the limits of accounting separation. In principle, no matter how well conceived and implemented, accounting separation does not change the incentives of an integrated firm. Accounting separation may provide some degree of increased transparency of a firm's operations such that the regulator may be able to identify and act against anti-competitive conduct. However this is extremely limited and is open to creative accounting practices which can result in misleading and inaccurate outcomes. It is ultimately as only effective in dealing with conduct in the market as the remedies for anti-competitive conduct that sit accompany it.

The CCC submits that accounting separation can never be effective in a fast moving industry such as telecommunications where there is one participant with the extensive market power presently enjoyed by Telstra. It tracks conduct after the fact when the damage has already been done to Telstra's competitors. It is a process of monitoring that is likely to be 1 to 2 years after the actual anti-competitive activity has taken place. The ability for the ACCC to undertake the necessary analysis means it will never fulfill its intended purpose. Measures need to be implemented that ensure the conduct is not permitted (ex anti provisions) or appropriate structural reform is imposed to lessen Telstra's market power.

It would appear other jurisdictions have concluded that specific ex anti provisions are necessary to deal with a dominant operator's incentive to abuse its market power. In other

jurisdictions ex ante provisions have been imposed despite the fact that the incumbent has often been prohibited in participating in certain parts of the telecommunications, information technology or broadcasting industries. In Australia, competitors face a vertically and horizontally integrated incumbent where the burden of proof about anti-competitive conduct is imposed on competitors and the regulator attempts to identify breaches based on information that is inaccurate and out of date.

The Commission comments in the discussion draft on the potential of accounting separation to identify anti-competitive behaviour.<sup>1</sup> The CCC recognizes that the Commission makes no attempt to assess the effectiveness of the present regime, but believes the comments in the draft report do require a response to clarify the limits of the arrangements presently in place.

The CCC submits that it is important to note that the present accounting separation regime, introduced in 2002, has not been effective in achieving any meaningful outcome, either in identifying breaches of the competition principles in the Trade Practices Act relating to telecommunications, or in creating any real disincentive for Telstra to attempt to abuse its market power.

The CCC believes it is important that this is widely understood because there have been public representations from Telstra to the effect that the accounting separation measures presently in place indicate Telstra has engaged in no anti-competitive conduct. It is clear that they do no such thing and that the present arrangements fall well short of providing an effective mechanism to identify such conduct in any but the most extreme cases.

It is instructive to consider that the accounting separation regime had, at the time of writing, resulted in three reports from the ACCC. Also, since March 2004, the ACCC had in place against Telstra a competition notice to the effect that Telstra had engaged in a price squeeze between its retail and wholesale residential ADSL products. The investigation of this matter has been the highest priority issue on the ACCC telecommunications group's enforcement agenda.

Yet, according to the commissioner responsible for telecommunications, Ed Willett, the ACCC "has only relied on the existing accounting separation arrangements to a very limited extent in relation to its imputation testing analysis of specific cases".<sup>2</sup>

Commission Willett also reflected that the three reports released to date might have served to confuse the public impression of the views of the Commission. He noted that the reports had concluded that the ACCC has "no major concerns with how Telstra is providing the specific services covered by the arrangements". But he said that this "is far from the clean bill of health that some have interpreted the Commission has provided Telstra in relation to these reports".

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<sup>1</sup> Productivity Commission Review of National Competition Policy Reforms Discussion Draft Pg 198.

<sup>2</sup> Ed Willett Address to AFR Telecom Summit, Sydney, 15 November 2004

“We noted that the information provided by Telstra is highly aggregated in nature and could mask specific instances of conduct requiring more detailed analysis,” Commissioner Willett said.

The ACCC has warned that without structural reform, either in the form of structural separation or some form of internal business separation, Telstra, and with it the rest of the industry, faces the prospect of more and more regulation<sup>3</sup>. The ACCC has pointed out repeatedly that the experience of regulation since 1997 has been the opposite of what was expected. That is, it was envisaged that as competition gained strength, regulation would decline. Instead, the ACCC has indicated that it is being required to regulate in greater and greater detail and scope.

The ACCC has pointed out that Telstra has the ability to reverse this trend through voluntarily or in co-operation with the regulator introducing greater internal separation. Perversely, however, Telstra might have more to gain from a highly regulated environment than any other participant. The regulatory burden and associated costs weigh very substantially on the smaller participants in the industry and represent a barrier to entry for businesses trying to come to market with new technologies in particular. Only Telstra and, to a lesser extent, Optus have the depth of resources that they can meet their regulatory obligations and participate in all the fora where the regulatory debate is conducted without that participation coming at the material expense of resources devoted to operational matters.

In other words, by acting in ways that force a greater level of regulatory intervention, Telstra can, effectively delay the entry into the markets of new businesses that might be competitive threats to its market position over the medium term.

This must be borne in mind when thought is given to the use of internal separation regimes in an attempt to effect outcomes similar to those that would be affected by the vertical and horizontal disaggregation of the industry.

Commissioner Willett was careful to emphasise that the usefulness of an internal separation of Telstra, even one that saw the business units run in separate locations with separate line operational management up to the point of the CEO, could be expected to do no more than make more practical the interrogation of Telstra’s internal pricing to identify anti-competitive conduct. He did not suggest that an internal separation regime would be as effective as actual separation in that it would not create genuine incentives for the internally separated businesses to deal on a true arms length basis.

An expansion of the present accounting separation regime (rather than internal separation that would include physical relocation of some operations) would be somewhere further short of the outcome under the model described by Commissioner Willett. This in turn would give rise to concern in the rest of the industry that there would be an increased compliance burden on other industry participants. The development and implementation

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<sup>3</sup> Ibid

of accounting separation would require the rest of the industry to participate to try to ensure that the best achievable outcome resulted. This is itself a drain on resources of the industry.

For example, the ACCC has created a consultative committee to advise on the existing accounting separation arrangements. This attempt to engage the views of the rest of the industry is in itself a laudable action, but given the lack of usefulness of the arrangements, smaller participants take a somewhat jaundiced view of the utility of participating in the activity.

While the Productivity Commission and others have pointed to what has been often referred to as reform fatigue in the Australian community generally when faced with a new round of competition reform, the telecommunications industry labors under regulation fatigue.

The CCC estimates below of the recent history of the growth in the volume of regulation and legislation illustrates this point.

- 1989 - 100 pages of legislation to regulate the industry
- 1991 - doubled to 200 pages when a duopoly introduced
- 1997 - up to 800 pages to introduce so called open competition, 10 separate pieces of legislation and multiple regulatory bodies
- Major amendments to the core legislation in 2001 to "streamline the Access regime" and in 2002, which included imposing advisory notice provisions that the CCC submits have made it more difficult for the ACCC to address anticompetitive conduct, and to introduce the existing, ineffective accounting separation provisions

In the UK, the industry regulator Ofcom, in a review of regulatory arrangements for telecommunications, has recently reported the difficulties making access arrangements work in the face of a powerful integrated incumbent have similarly resulted in "regulatory micro-management".<sup>4</sup> It argued that the current market structure and regulatory arrangements were unsustainable in the face of technological change.

Without a new burst of policy reform to reinvigorate enthusiasm for competition in the industry, the faith of participants in the ability of regulation to support good market outcomes is likely to wane further, to the detriment of investment, consumer benefit, and the broader economy that relies on good, cost-effective communications services.

## **The Contribution to Growth of Telecommunications**

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<sup>4</sup> Ofcom Strategic Review of Telecommunications Phase Two Consultation Document November 2004.

The CCC notes the Commission's estimate that the NCP reforms to date have resulted in a benefit per Australian household of \$7000 per annum, and that the potential for further reforms that took Australia to the same levels of productivity as the US amounted to a further \$22,000 per household.

The CCC agrees with the Commission's conclusion that telecommunications reforms, as qualified as they have been in delivering competition to the communications markets, have made a significant contribution to the economic benefits to date.

However, the CCC believes that the potential for further contribution to national growth from telecommunications is more significant than that of the utility industries such as electricity and gas with which telecommunications is often compared.

This is because telecommunications is presently experiencing historic technological shifts on a number of fronts, all of which present opportunities for a step improvement in productivity at the level of the business and the individual. Most important of these are:

- The deployment of true broadband access networks;
- The commercial release of voice over Internet Protocol products into corporate and consumer markets, and;
- The rise of mobile communications, especially converge voice and data mobile products.
- The introduction of a raft of fixed wireless technologies able to deliver broadband services

Australia has experienced a rapid acceleration in the growth of ADSL connections to residences in the past six months. This has been driven by an aggressive retail price discounting strategy by Telstra that resulted in the ACCC imposing a competition notice on that company. However, the standard ADSL product that Australia has accepted as broadband is 256 kilobits per second download speed.

This falls far short of the accepted international definitions of broadband, and of the standard products increasingly being offered in more competitive markets.

The International Telecommunications Union defines broadband as any speed above 1.5 Mbps.

Furthermore the imposition of download caps and other such capacity restrictive practices initiated by incumbent providers are contributing to limiting of growth in the broadband market.

In overseas markets accepted speeds for broadband are racing ahead of that available in Australia. In Canada, standard cable modem download speeds are now 5 megabits per second. In Korea and Japan, residential broadband speeds of 2 Mbps are standard.

In many other countries, 512 kbps is the now the entry level product download speed. However, the ITU has pointed out that the term represents “a moving target” and that its own definition is likely to change to incorporate higher speeds..<sup>5</sup>

The distinction between true broadband and the faster access products sold as broadband is important because the number and types of services available to users are a function of speed. The product sold in Australia as broadband is really faster Internet access. True broadband is a platform capable of delivering to homes all data products presently accessed through a variety of means – Internet, voice telephony, video for example – and the many other information services that can be expected to emerge once mass market true broadband is deployed.

Voice over Internet Protocol, or VoIP, is a fundamentally different technology from traditional circuit switched telephony. In short, it treats voice as another form of data and delivers it through the same network. Although VoIP is by no means a new technology, its widespread application into markets ranging from residential consumers to corporate customers has only shown signs of accelerating. This is because the technology has evolved into more stable forms and more markets (especially in the US) have achieved a critical mass of always on, higher bandwidth-connected consumers able to download, install and use VoIP software to their computers.

Around the world, incumbent telecommunications carriers have been resistant to the deployment of VoIP because it threatens their lucrative circuit switched voice businesses. This has been one of the reasons that, where not compelled by competition, incumbent telecommunication carriers have been slow to deploy higher bandwidth access technologies. They have known that the longer they could delay the growth of high bandwidth connectivity, the longer they could forestall the threat to their lucrative voice revenues.

High speed converged mobile voice and data networks, such as 3G, have the potential to create a similar fundamental shift in the price of traditionally relatively expensive services. The rapid uptake of services such as SMS text messaging and picture messaging shows that there is a strong consumer willingness to embrace more data-based mobile services. 3G mobile services can treat voice products as one of a suite of products in the same way as VoIP converges voice with other data as simply one of many software applications. In Australia, Hutchison introduced flat priced monthly call plans on its 3 network and other networks have been forced to follow suit. Again, it was Telstra, the biggest of the mobile voice retailers, that was last to move to this pricing model.

Internationally, incumbents have sought where possible to delay the uptake of new 3G services featuring disruptive pricing models by aggressively bundling mobile voice services with other communications services, especially in corporate markets, but increasingly in residential markets also. In this way, they slow the market penetration of new entrants that have built 3G networks and forestall their own need to similarly invest.

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<sup>5</sup> The Birth of Broadband. ITU September 2003

The CCC submits that there are two ways in which a more competitive telecommunications environment will contribute to greater productivity growth. Firstly, competitive entry will stimulate the faster deployment of broadband access networks, both by the new entrants and by incumbents seeking to protect their market position. Secondly, once true broadband access networks have been deployed, uptake and further development is quicker under an open access model than a vertically integrated ownership model.

The CCC has commissioned from the Centre for International Economics a brief analysis examining of the impact of a broadband access network on economic output, and of the relative impact of such a network operated on an open access basis compared to an integrated ownership basis. This submission will be forwarded separately when it has been completed.

## **Conclusion**

The CCC strongly supports the Commission's contention from its draft report that there is much to be gained from a further program of national competition reform. Further, the CCC believes that in telecommunications there has not only been a sub-optimal result from reforms to date, but that there is reason to believe that telecommunications internationally is in the process of a number of fundamental shifts in core technologies. These shifts will result in a new generation of services becoming available, but the pace of these and their impact on the pricing of services will be very much affected by the competitive pressures in the various markets for communications services.

The right competitive market coupled with these technology advances will deliver significant macro and micro economic benefits to Australia.

The CCC has requested an opportunity to present to the Commission at the public hearings of this inquiry to discuss these matters further

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