## **Australian Consumers' Association**

### submission to the

## **Productivity Commission**

## Inquiry into Telecommunications Specific Competition Regulation<sup>1</sup>

#### Introduction

The Australian Consumers' Association (ACA) is a not-for-profit, non-party-political organization established in 1959 to provide consumers with information and advice on goods, services, health and personal finances, and to help maintain and enhance the quality of life for consumers. The ACA is funded primarily through subscriptions to its magazines, fee-for-service testing and related other expert services. Independent from government and industry, it lobbies and campaigns on behalf of consumers to advance their interests.

The ACA intends to make a brief submission to this Inquiry, addressing points of principle rather than detailed legal or economic arguments. Nevertheless, we feel that the Commission should take note of consumer concerns in this Inquiry and not lend excessive weight to the most plausible line of argument corporate money can spin. The discussion is carried forward under a series of key questions. We believe the answers convey us to an inescapable conclusion – that telecommunications specific competition regulation must be retained. While it may be attractive to conjure with the notion of using general competition rules, or perhaps extending them to deal with network industries, this vision must not be used to dismantle the specific telecommunication rules before any effective substitute exists. It is also clear that the enforcement of telecommunications competition regulation must be made more immediate, certain and effective in its operation.

# *Is the Australian telecommunications industry competitive; is the transition from state owned monopoly complete?*

There is doubtless significant kudos to be gained for various interests in declaring the migration of Australian telecommunications to a competitive marketplace done. It would enable the regime of specific regulation to be wound back. It may smooth the way for further privatisation. It would endorse the principles of co-regulation and so forth used to govern the sector. It would be a pat on the back for government and industry.

Unfortunately, it does not seem that effective competition has emerged across the whole telecommunications landscape of Australia. The key consumer area that is not being contested is the local loop. It is interesting to note the conclusion reached about the state of the US telecommunications market by consumer advocates in the report

<sup>&</sup>lt;sup>1</sup> ACA File Reference 000434

"The Digital Divide Confronts The Telecommunications Act Of 1996 - The First Triennial Review February 1999" by the Consumer Federation of America and Consumers Union

#### THE FAILURE OF COMPETITION UNDER THE ACT

The Telecom Act's fundamental premise that breaking down legal barriers to market entry would unleash a barrage of facilities-based competition in which cable companies used their infrastructure to attack the local phone market, and local phone companies used their networks to attack cable, has proven wrong. ...

One of the other great disappointments of the Telecom Act has been the failure of competition from alternative technologies to break down the market power of the incumbents. ... Head-to-head competition across industries with wireline technology has failed. Cable companies have failed to successfully move into local telephony and telephone companies have all but abandoned entry into cable.

Wireless technologies have also failed to break the local monopoly. Cellular telephony and satellite video delivery are two to four times as expensive as the incumbent, wireline service. They fill premier, niche markets but do not represent effective competition for basic service that can exercise price disciplining power over the incumbents.<sup>2</sup>

In the US telecommunications market (although very different to, arguably more mature than, the Australian) the Digital Divide Report notes prices for key groups of consumers in the US have in fact gone up. It makes the observation:

It is time for policymakers to stop pretending that competition is right around the corner. It is unrealistic and possibly duplicitous to pooh-pooh today's price hikes as nothing more than a short-term setback or to blame the failure of competition and the absence of promised price reductions on regulators standing in the way. Policies must be adjusted to reflect the reality that the core telecommunications and TV services that are consumed in modest quantities by average consumers are and will be provided under monopolistic conditions for the foreseeable future.<sup>3</sup>

The case is made that for a considerable number of consumers telecommunications market failure will always be just around the corner. This perspective should be borne in mind when considering the evolution of the Australian market and its regulation. In the local call market place, it seems extremely unlikely that multiple entrants, let alone vigorous competition will shortly emerge in other than premium markets, markets that can support bundling and CBD-like business markets. This is reflected in persistent pressure to rebalance local call network access and line rental fees with call charges to the detriment of low use, low value contributing consumers. It perhaps can also be seen in the recent increases in long distance call prices by

<sup>&</sup>lt;sup>2</sup> http://www.consumer.org/other/telecom4-0299.htm Pvi

<sup>&</sup>lt;sup>3</sup> http://www.consumer.org/other/telecom4-0299.htm Pviii

Telstra – telecommunication prices can go up according to what companies decide the market can or will pay.

Other telecommunications markets by and large have the appearance of oligopolies. A semblance of competition is perhaps produced by the existence of resellers, but they are captive of wholesale markets that are not very competitive. We would endorse measures designed to sustain competition by creating and enforcing effective separation between wholesale and resale layers in vertically integrated players. In our opinion it is only the existence of the telecommunications specific provisions under consideration that have produced what competition does exist. It would indeed be premature to contemplate their removal.

# *Is there a particular need for telecommunications specific competition regulation and is it a permanent or temporary need?*

There is perhaps a view that telecommunications specific competition regulation is unnecessary, and maybe untidy. The purist may ask what differentiates telecommunications sufficiently to merit special treatment. The answer is not truly confined to telecommunications specifically. The question is whether general competition law as it stands can deal with market places that:

- Have significant (residual) incumbent market power.
- Are technically complex.
- Are based on networks.

Each of these is discussed in turn.

#### **Technical complexity**

Standards take on a particularly pivotal position in the digitally convergent world. Interconnection is essential. How things interconnect and continue to provide a seamless consumer experience (interoperate) is defined at a technical level by agreed standards. In the analogue world, standards are a rather boring technical arena where boffins argue intricate wiring issues. In the digital world, control of technical standards is one of the key choke points, the place at which to levy the road tolls of the digital data highway. That is not boring at all, as Microsoft has comprehensively demonstrated. For the consumer however, the options available can be diminished or made more expensive. Standards become the place for bitter tussles, as illustrated by the corporate turf war that erupted over the definition of digital television standards for Australia. The interests of the consumer were of marginal interest to most players. Standards processes are typically voluntary, consensus oriented and cooperative. As they come to represent the competitive commercial high ground in the digital world, it is likely that regulators, probably on a worldwide basis, are going to have to take a specific interest and stake in the development of digital, network and communication standards to preserve the interests of consumers.

#### **Network based**

Connectedness is critical to networks. In the non-connected world each device is effectively in isolation, except for the service provider. Thus a user of a power point doesn't care who is plugged in to some other power point so long as they do not overload the system. They could be the only power user in the world, and it would

make no difference to the operation of whatever is plugged in. But the same does not apply to telephones (even analogue ones). The effect is magnified in the digital networks. Emailing yourself is tedious and pointless. The same with fax. The more people there are on the networks, the greater the potential utility of the network to all. Excluding people from the networks on bases like poverty or geographic location reduces the value of the network, not only to those who cannot get on, but also to those who are on but cannot access their absent friends (or potential customers, partners, relatives, or community members).

As the tide of digital change washes across the communications and media landscape, the notion of universal service is periodically challenged. Critics note that the notion of universal voice telephone access has been extended to data. "Where will it end?" they ask despairingly, "Will it get ratcheted up with each technological innovation?" And of course, the answer is 'Yes'. And so it should be. Universal service is needed not just because it is about equity and something the people at the margins of our society need (although that is true). It is critical because it mirrors at a social level the digital need for interconnection and access at the technical level. It matters to all the users of the system that other people can access and use the various networks. The more people there are on the networks, the greater the potential utility of the network to all. Therefore, in our opinion, the special nature of network industries does require a specific regulatory response.

#### Incumbent market power

The remarks above about the transition of telecommunications from state owned monopoly convey our low opinion of the extent to which the power of the previous monopoly incumbent has been diminished. It is also a characteristic of network industries that either standards, or connectedness, or a combination of both can rapidly lead to market domination from percentage of market share which are lower than traditionally felt to be indicative of market power. Commentary about the proposed purchase of the Ozemail ISP operations by Telstra explored this aspect of network marketplaces. Among other concerns expressed, it was felt that the addition of the Ozemail customer base to that of Telstra could lead to 'tipping'. This effect could lead to the market share of the combined entity rapidly coming to dominate the market as the advantages of being connected to the major player became increasingly apparent to consumers connected to the remnant providers.

A similar effect can be observed in software markets where for instance use of Microsoft Office products has become a de facto standard for electronic document exchange. Not using the products creates translation and ease of use issues that mean it is simply easier for consumers to go with the flow and in the end the vast majority do. Huge market share and almost complete domination can result. The US system has felt it necessary to intervene in the Microsoft case. Specific network economy access rules and open standards requirements may have made this intervention more timely and effective from the point of view of consumer interests and economic benefits flowing from freer markets.

A critical aspect of incumbent market power in the telecommunications industry at present is the situation with backbone fibre and the upgrade of the carrying capacity of these fibre routes. The physical capacity of that infrastructure is being expanded –

increased strands of fibre from 6 or 12 in 1970's to 60 today.<sup>4</sup> Then there are the developments in data carrying capacity of these fibres, which are enormous. Single fibre in the mid 1980's carried 140 or 565 m/bit/s. Wave division multiplexing has led to routine capacity today of 40 g/bit/s. Dense wave division multiplexing increases this further. Fujitsu has announced 320 g/bit/s<sup>5</sup>. Nortel demonstrated 1.2 t/bit/s over 440 km on 1 fibre pair at Telecom '99<sup>6</sup>. Recently Harry Bosco, chief technical officer Bell Labs commented on a trend to double the capacity of a given fibre every 9-12 months. His suggestion is that "within a few years, it could be possible to bundle over 800 fibres in a single cable with each carrying 10,000 2.5 gbit/sec channels"<sup>7</sup>, which by back of the envelope maths is 20 peta-bit-sec.

These technological advances mean that there may actually be an over abundance in the core telecommunications infrastructure, the backbone networks which carry the aggregated traffic. The big question is the extent to which these technologies also translate into consumer benefit. The critical point is that the data carrying capacity enhancements can be applied to the existing fibre in incremental upgrades. The infrastructure owner controls the growth in supply, which can be carefully matched to shadow growth in demand without disturbing business models or profits. There is an obvious potential for this overhang of capacity to reinforce monopoly tendencies and reduce incentive to invest in backbone fibre beyond actual demand at current prices. It is not clear, therefore, that this bandwidth bonanza will bring commensurate capacity and speed benefit to the consumer.

The National Bandwidth Inquiry Discussion Paper concluded, "The customer access network is in general likely to be a more important potential choke point in servicing bandwidth needs than the trunk network".<sup>8</sup> It would seem that the essentially 'free' bandwidth on the backbone may actually reduce consumer choice when combined with monopoly / duopoly / oligopoly ownership of facilities. Consumer costs will be held up in data network access bottlenecks. We must wonder what the incentive is for anyone to remove the bottlenecks, since these are what offer the business opportunities to make money in the data carriage business. A regulatory response is needed, and highly specific response at that.

Therefore, it would seem that the need for such specific rules is in the nature of network industries such as telecommunications and that as a consequence the need for competition rules to be tailored to their characteristics is a permanent feature of the modern economy rather than a temporary transitional requirement of traditional government monopoly busting.

# Should competition regulation reflect the force of telecommunications specific competition regulation in a broader convergent or network economy provision?

From the preceding discussion, the conclusion could be reached that rather than scrapping the telecommunications specific competition regulation, we should be extending its provisions to cover network areas of the economy. This would obviously

<sup>&</sup>lt;sup>4</sup> National Bandwidth Inquiry Discussion Paper September 1999 P47

<sup>&</sup>lt;sup>5</sup> National Bandwidth Inquiry Discussion Paper September 1999 P48

<sup>&</sup>lt;sup>6</sup> Michael Biber ACIF Future Network Directions Seminar 27 Oct 1999 Slide 11

<sup>&</sup>lt;sup>7</sup> exchange, 3<sup>rd</sup> Wave Communications 4 Feb 2000 P8

<sup>&</sup>lt;sup>8</sup> National Bandwidth Inquiry Discussion Paper September 1999 P109

include telecommunications, as well as broadcasting, computer software and hardware platforms. Utilities such as power and water would benefit from such network provision as well Broadly defined, as the reach of electronic commerce makes them increasingly networked, industries such as finance and education may find that notions of access and universal service, standards and interoperability have increasing relevance both to consumers and regulators.

There would certainly seem to have been ample scope for the application of competition principles and insights to the recent decision making with regard to digital television. The definition of datacasting in particular seemed to miss the notion of competition entirely, as it focussed on preserving the bailiwick of incumbents and squeezing the space for innovative services so tightly as to discourage all but the most brave (or foolhardy) of aspirants. There has now been an expeditious and perhaps expedient review in the negative of the question as to whether streaming audio and video over the Internet should be regarded as broadcasting. While this has saved the Australian Internet from the indignity of genre-based rule and the banishment of entertainment from its portals, it would be far better if such questions were resolved in a pro-competitive regulatory environment that can preserve interoperability and access to the benefit of consumers, rather than a politically fraught scramble. Digital convergence nudging industries onto networks will make this competition based approach increasingly necessary.

However, and it is a *large* 'however', our opinion is that such a change should be achieved by extension of the telecommunications specific competition regulation framework, rather than the removal of these specific provisions and some sort of 'upgrade' to the general competition provisions.

# What regulator should enforce telecommunications specific competition regulation?

We note the Draft Conclusions of the New Zealand Ministerial Inquiry into Telecommunications that "industry-specific regulation is warranted"<sup>9</sup>, which is consistent with the thrust of our arguments above. This is particularly apposite from a domain where the use of general competition law has been on trial. However the Inquiry also formed the view that there should be appointed "an industry-specific regulator – the Electronic Communications Commissioner."<sup>10</sup>

It may seem attractive to create a separate competition regulator for communications or network/convergent industries, perhaps with other regulatory functions rolled in. However, it is the view of the ACA that the ACCC remains the best body to administer the regime of telecommunications specific competition regulation. It creates the environment to align competition regulation in telecommunications with that in other industries, which as indicated above could over time benefit from extending the notions embodied in the telecommunications scheme into other industries as network effects invade more and more aspects of the economy. It is interesting to note that this was the thinking reported in the UK Department of Trade and Industry report "Regulating Communications: The Way Ahead

<sup>&</sup>lt;sup>9</sup> http://www.teleinquiry.govt.nz/reports/draft/index.html Section 3.6.2

<sup>&</sup>lt;sup>10</sup> http://www.teleinquiry.govt.nz/reports/draft/index.html Section 4

Results of the Consultation on the Convergence Green Paper", which noted that while:

There was no clear consensus for a particular regulatory structure in the longer term ... Where a preference was expressed, the most widely supported model was a single content and a single economic regulator, variously in one organisation or under an umbrella organisation, independent from Government Departments or reporting to them.<sup>11</sup>

The ACCC has successfully built specialised expertise in the telecommunications domain, but the function of competition regulation remains embedded in a framework resourced and oriented towards effective and realistic regulation. Our view is that it should continue to do so, but must be resourced sufficiently to play its part in quickly and effectively advancing the cause of competition in telecommunications.

We would also endorse the comments made in the CTN submission to the Inquiry, that "From a consumer perspective, however, competition is only a good thing if it brings more choice, better service and cheaper prices".<sup>12</sup> Rampant competition red in tooth and claw can be deleterious to consumers, as excesses in the mobile sales and customer churn issues have demonstrated. In that regard, it is important to note that the ACCC supplies the context for another critical issue – consumer protection. Informed and discerning consumers operating in a market place with structures to protect them form the excesses of competition are vital to the effective functioning of competition policy, as reflected in the constitution of the ACCC and indeed its very name. The marketplace choices of consumers are where competition actually happens.

# Could the scheme of telecommunications specific competition regulation be improved?

Far from the program of encouraging competition in telecommunications being sufficiently advanced for specific regulation to be wound back, it would seem that the experiment has been advanced sufficiently only to diagnose what would make the idea work better. The chief evil mentioned in commentary on the operation of the system is delay. Delay in settling interconnect and access pricing, delay in settling arbitrations and disputes, protracted self regulatory processes and slow resolution of competition issues generally. Overall the impression is that delay favours the incentives for timely settlement of issues, in a framework that does not discriminate against the usually smaller and weaker access seekers and preserves the interests of consumers would provide greater certainty for business and contribute to the more speedy generation of competition inspired benefits for consumers.

For example providing the ACCC with powers to require parties to cease and desist from anti-competitive conduct while a resolution is sought would increase incentives to resolve competition issues, while improving the sensitivity of the system to market entrants. The ACCC should be able to set industry wide reference prices rather than get bogged down in incessant arbitrations, which consume resources resolving

<sup>&</sup>lt;sup>11</sup> http://www.dti.gov.uk/cii/convdoc.pdf

<sup>&</sup>lt;sup>12</sup> http://www.pc.gov.au/inquiry/telecommunications/subs/sub017.pdf P2

essentially private disputes between parties that could perhaps be more usefully deployed directly pursuing public interest goals.

Self-regulation is useful to the extent that it delivers outcomes. The slowness of the self-regulatory system in telecommunication when grappling with competition and consumer issues has come perilously close to vitiating its usefulness. The system in the shape of the TAF has practically broken down. There should be greater scope and requirement for regulators to step in and move the market processes along where it is evident that delay is threatening desirable outcomes from the point of view of competition or the public interest.

#### Conclusion

Telecommunications specific regulation in Australia helps to ensure access to infrastructure by entrant carriers and portability of connectivity by consumers. It is important that the telecommunications market continues to grow and that it remains interconnected and interoperable. Access regimes to ensure that content can span and interconnect across the increasing number of digital networks are critical. These imperatives will undoubtedly emerge in other digital markets, some of which, like broadcasting have been shielded from competition. There will probably be access seekers to digital television spectrum, to cable, microwave and satellite systems for digital purposes, not all of which will be traditionally telephonic. Therefore, it may be that there will be a requirement to beef up general competition regulation with improved access guarantees or perhaps extend telecommunications specific provisions for competition regulation of digital or networked industries. But it is important that in the meantime telecommunications system regulation is not abandoned prematurely or altered in ways that may disadvantage consumers.