The Senate Committee on the
Environment, Communications, Information Technology and the Arts
Parliament House
Canberra ACT 2600

29 March 2005

Dear Sir

Inquiry into the performance of the Australian telecommunications regulatory regime

As an independent person with long involvement in the industry at strategic, operational and regulatory levels and not beholden to any vested interests in the telecommunications industry, I wish to provide the Committee with a view upon the relative significance of the various terms of reference for an effective regulatory regime. Experience suggests that many other submissions will not provide a similarly detached overview. I leave it to those with relevant interests and greater resources to provide the Committee with more detailed comments upon the individual terms of reference.

As a starting point, it is important to recognise that the Australian regulatory regime is not directly equivalent to any other regime in the world. The organisational lynchpin of our regime is the general competition regulator (ACCC), with other regulatory agencies fulfilling more industry specific roles and the Department and Minister having policy responsibility. When seeking to benefit from overseas experience, it is necessary to keep in mind these and other peculiarities of the Australian telecommunications environment. Whilst there may be scope to improve allocation of regulatory responsibilities in Australia, there is no pressing need for changes to the general structure of regulation. Any changes should be initiated by consideration of policy and legislative requirements.

Now, recognising the interrelated nature of some of the Terms of Reference, the following specific comments are made:

TOR (a) – *Abuse of market power*

This is the 'big stick' of the regime and its effectiveness relies as much in being a potential threat as an actual regulatory weapon. As such it should generally be reserved for critical situations and not applied excessively to relatively trivial disputes. The ACCC seems to know how to wield this stick, as was demonstrated quite recently.

TOR (b) – *Access*

This is the 'engine room' of the regulatory regime. There are few easy yards to be made here, but it is absolutely essential that the ACCC provide for stable expectations, appropriate degree of declaration and correct price signals. Ideally access might be better handled as far as possible by commercial negotiations, but the reality of highly interconnected telecommunications is that there will always be a requirement for refereeing and/or avoiding disputes. Access pricing is critical to future performance of the industry. The investment lead times in the industry are mostly lengthy and the impact of inappropriate access pricing takes a long time to emerge. If prices are set too low, investment by either access seekers or providers will dry up, resulting in poor service provision. Prices that are too high may produce overinvestment in access provision or discourage other investment requiring access. Given the difficulty in determining appropriate access prices, it is probably better to err on the side of the latter.

TOR (c) – *Industry structure*

Industry structure has historical dimensions, but changing technology together with competition is constantly modifying the structure of the industry. Attempts to intervene in this process by legislative second-guessing of structural changes are unlikely to be more productive than allowing other regulatory and market processes to run their course.

As a result of an antitrust court decision in the United States twenty years ago, the Bell System was broken up. In the intervening period much time has been wasted on bureaucratic regulation, some innovation has been retarded and there was extensive overinvestment in transmission capacity. The industry in USA is now reforming on lines not too dissimilar from the original ones, allowing for advances in technology and competition in the meantime.

It is yet to be demonstrated that legislated structural changes in other industries in Australia have produced superior long-term results than could have been achieved by other less disruptive means. There has in fact been much recent talk about 'bottlenecks', suggesting separation of 'infrastructure' from 'service provision' may have its problems even in relatively simple network industries.

In telecommunications such separation would be likely to result in inappropriate as well as inadequate investment in infrastructure; that is assuming that the 'infrastructure' could actually be identified separately from services equipment and after it was done, that the purpose or use of the infrastructure would be known. The Minister recently described regulated separation of Telstra as 'a dangerous and irresponsible leap into the dark', but instead of the dark she might have said darkness – it represents a proven failed prescription for yesterday's problems.

The Committee could save itself and everybody else much wasted time by immediately consigning this TOR to the too-hard basket.

TOR (d) – *Consumer protection*

This seems to be a palliative applied by politicians when they think that their constituents may be less than convinced by their efforts to regulate an efficient industry. It is difficult to see why this attempt at second-guessing consumer preferences should be superior to market signals and it results in bureaucratic time wasting. An effectively regulated market is much more likely to provide most consumers with what they want.

There may be a justifiable requirement for consumer protection in instances of market failure, thus the need for consumer protection should be confined within the Universal Service Obligation regime.

TOR (e) – *Regulatory powers and resources*

It is now thirteen years since the monopoly ended and eight years since open competition commenced. These are modest times in terms of telecommunications investment cycles. We now have a competitive market for mobile telephones, an increasingly competitive market for provision of Internet services, developing alternative mobile and fixed wireless access options as well as a wide variety of specialist products provided by market participants. An established market should generally require less regulatory effort.

Thus, even though one may still hear discordant noises from some service providers, much of the effort to establish an effective regulatory framework has already been undertaken. In these circumstances resources should be focussed on identified problem areas through the application of those regulatory powers that are appropriate for the purpose. The ACCC should be scrutinised carefully if requesting additional powers, but unused existing powers do not do much harm.

TOR (f) – *Effect of Telstra privatisation*

Superficially, the privatisation of Telstra should not have any effect on the regulatory framework.

However, things may not all be as they would seem to be. Depending upon what one considers implementable best practice technology for provision of the Universal Service Obligation (USO), Telstra is currently only permitted by legislation to claim for about one third of the avoidable cost of uneconomic service provision resulting from the USO. Whilst nobody would be prepared to make any admission, it could be surmised that the management of Telstra, in its enthusiasm to be privatised for several other reasons, has been prepared to

finance the difference in cost through application of market power, whilst the Government and regulators looked the other way. Whatever, the competitors to Telstra have not been obliged to fund their full share of the USO avoidable cost.

There can be no assurance that in the future Telstra will be able to continue to exercise such market power or that its shareholders would continue to regard the unfunded costs benignly. Increasing intensity of competition is likely to reduce any ability to wield market power. We do not know who the future shareholders of Telstra will be. Australians were promised that the alternative carrier would be Australian owned, but the incumbent carrier in Singapore now owns it. New Zealand's incumbent carrier owns another significant competitor. Whilst Government Ministers may cross their hearts and hope to die if a similar fate should befall Telstra, why should we have any more faith in such promises than similar promises about Optus? For reasons of financial stress (eg. many European and North American carriers not so long ago) or shareholder expectations, there can be no assurance that the future owners of Telstra would allow the existing USO situation to prevail. The future owners are more likely to act like Telstra's competitors, which have made every lawful effort to avoid financing any of the USO cost.

TOR (g) – *Universal Service Obligation*

The wording of this term of reference seems to imply new purposes for the Universal Service Obligation, since the stated requirement of "providing access to reasonable telecommunications services" differs from current legislated requirements. The legislation currently provides that:

> *'the objective of the universal service regime is to ensure that all people in Australia, wherever they reside or carry on business, have reasonable access to standard telephone services, payphones and any other prescribed services, on an equitable basis'.*

The 'standard telephone service' is a clearly defined basic means of communications. 'Equitable basis' has been understood to mean at prices similar to locations where the service is provided on a commercial basis. In rural and remote locations where customer access costs are high, these requirements give rise to providing the service on a non-commercial basis, thus incurring the USO cost.

A further purpose of the legislation is for this USO cost to be borne by the industry through a fund to which industry participants contribute in proportion to their eligible revenues, with the intention that provision of the uneconomic services would be competitively neutral. In this intended situation there would be no strong disincentive for the service provider not to provide the service.

A further requirement of the legislation is that the cost of USO provision is to be determined on an 'avoidable cost' basis. This cost is calculated on an economic

basis, which means that the cost to be shared by the industry is only that cost which the provider would avoid if it did not provide uneconomic services. The USO cost thus takes account of all economies of scale available to the USO provider as well as excluding common infrastructure costs used to provide commercial services (eg to adjacent towns). It has also been costed on 'best practice' technology, which means it is generally lower than currently being achieved and even without legislative capping, not necessarily cognisant of what could actually be achieved in practice.

Most options to provide more 'reasonable communications services' have been rejected on the basis of excessive increase in the USO cost. Telstra has made available some improvements in bandwidth within the limits of existing technology, but for example, the requirement to provide the 'digital data service' specifically excludes the highest cost locations (approximately 4% of total service locations).

The Committee needs to be aware of the Magic Puddin' syndrome. The way this syndrome works is that politicians and their constituents seek to increase the standard of service, thus raising its cost, whilst at the same time reducing the allowable USO cost so as to limit the cost burden on the industry. Telstra is the magic puddin', which by some unknown miracle is able to provide higher-level services at lower costs – the issue is clouded by the fact that technological advances have if fact permitted some efficiency gains to arise in other parts of the business.

Unless this problem is realistically addressed, then as surely as night follows day, the recipients of uneconomic services will in future either receive a lesser quality of service or they will be required to pay substantially more for it. It has been suggested that Government could fund the cost. In the light of past Government USO cost decisions and experience with budget decision-making processes, the best that could be expected from this option is that it would provide a backdoor means of phasing out USO funding and service provision.

TOR (h) – *Promotion of investment*

Requirements to provide access to infrastructure at regulated prices, with specific standards of customer service; to bear unrecovered costs, or control of service prices all have the potential to deter investment. Investment evaluation involves assessment of future cash flows and the impact of any investment upon these cash flows. New investments typically have lower cash flow in early years than in later years. Estimation of cash flow involves assessment of risks to each of the cost and revenue components.

Regulation has the potential to kill investments either through resulting in insufficient cash flow based upon present regulatory requirements or by

unacceptable risk that assumptions will not be realised through future changes in regulatory requirements.

Much of the present regulatory regime has been predicated on existing investment, which is thus in a fairly mature stage of its life cycle with relatively stable cash flows. Major new investments, such as rolling out fibre to the home, would be unlikely to occur any time soon unless different concepts of access pricing are applied in a way that provides predetermined certainty as to regulatory requirements. Removal of unnecessary service standards, costs and price controls would also be of assistance in promoting investment.

Rebalancing, unbundling and de-averaging of prices, involving removal of cross-subsidies inherited from a monopoly environment, is also desirable for encouraging economically beneficial investment as well as retarding overinvestment in services providing the cross-subsidies (eg transmission networks). In the opinion of this observer, it would have been beneficial if Telstra had been encouraged to remove the 'access deficit' much sooner through rebalancing revenues from usage charges to access charges, as has been occurring recently. Whilst competition should generally promote such changes, this is not to say that some cross-subsidisation will not occur for good commercial reasons in competitive markets (eg mobile handset subsidisation).

TOR (i) – *Innovation*

Increasing competition over the past eight years has undoubtedly resulted in a great deal of innovation in services utilising new technologies, so the present regulatory framework cannot be entirely bad.

Nevertheless, the above comments on promotion of investment will need to be kept in mind in the future, if innovation is to be encouraged as it should be.

TOR (j) – *Scale and scope of regulation*

The Committee would be well advised to study the Telecommunications Competition Regulation Report by the Productivity Commission published in 2001. In addition to its recommendations, this report provides much useful and detailed information concerning the workings of the regulatory regime.

Enduring features of the telecommunications industry are large economies of scale and scope, particularly in accessing customers, combined with an essential requirement for interconnectivity. Hence for the indefinitely foreseeable future, Parts XIB and XIC of the Trade Practices Act 1974 will be required, either in their present form or as more general provisions of The Act. Arising from this legislation are a number of requirements for reporting information and the development of guidelines etc.

There will also be an ongoing requirement for licensing and regulation of scarce resources such as radio spectrum and numbers as well as for maintaining technical standards facilitating interconnectivity, network security and network performance.

If we wish to retain a social commitment to provision of the standard telephone service (basic communications in isolated locations) on an equitable basis, then it would be desirable that the present distortions in the Universal Service regime be removed. Otherwise, the Universal Service Obligation might just as well be abolished, as it will not work in the longer term in its present form. This was confirmed by the wishful thinking concerning competitive provision of the USO.

Legislated compliance with pricing controls and customer service standards should be abolished. In the unlikely event that a future need could be demonstrated for these, then relevant controls could be reintroduced. Removing these unnecessary belts and braces would focus attention where it belongs on the other regulatory legislation and remove bureaucratic time wasting.

TOR (k) – *Other changes*

The Committee should give consideration to the fundamental change in the telecommunications industry being brought about by the change from the Public (circuit) Switched Telephone Network (PSTN) to packet switched Internet Protocol (IP). British Telecom has announced an intention to close the PSTN by 2010. Within the timeframes of telecommunications investment, whether it is 2010 or some later date is immaterial; it will happen.

So the abovementioned price controls might soon become useless anyway. Much of current regulatory activity is focussed on the PSTN, which before long will become redundant, so the future regulatory framework should address the trade-offs between security, dependability, innovation and costs in a packet switched world where voice and data communications converge. A number of aspects of regulation currently taken for granted may no longer occur in the IP world or may require radically different approaches.

Yours faithfully

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