

TELSTRA INQUIRY

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Telstra Inquiry

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Table of Contents

Chapter number:	Page number:
1. SYNOPSIS	1
2. COMMENTS ON THE INQUIRY	1
2.1 NETCO AND SERVCO	2
3. GOVERNMENT UNDERMINING DEMOCRATIC PROCESSES?	3
4. REGULATIONS HAVE FAILED TO DELIVER COMPETITION	4
5. TELSTRA	4
5.1 FINANCIAL SUCCESS STORY	4
5.2 SUCCESSFULLY ELIMINATED THE THREAT OF COMPETITION	5
5.3 TELSTRA IS UNTOUCHABLE	5
5.4 THE STRANGLEHOLD OF A VERTICAL INTEGRATED TELSTRA	5
5.5 TELSTRA MOVING INTO THE MEDIA MARKET	5
6. ARE DISASTERS NEEDED BEFORE WE SEE CHANGES?	6
7. THE FALL OUT FROM THE FOXTEL DEAL	6
8. COMPETITION BILL WILL NOT IMPROVE COMPETITION	7
9. CROSS PLATFORM COMPETITION.....	7
10. GOVERNMENT WILL HAVE TO TAKE A LEAD	7
 <u>APPENDIX 1</u>	
1. STRUCTURAL SEPARATION UNDER DISCUSSION.....	9
2. AUSTRALIAN TELECOMMUNICATIONS REGULATIONS.....	9
3. THE POLICY CONTEXT	9
3.1 THE COMPLEX BUSINESS OF DEREGULATION	9
3.2 INTERNATIONAL CONTEXT	10
3.3 TECHNOLOGICAL CHANGES.....	10
3.4 SOCIAL AND ECONOMIC ISSUES	10
3.5 CHALLENGES AHEAD OF THE GOVERNMENT.....	10
4. DEALING WITH THE CONSEQUENCES: POST-1997.....	11
4.1 INTRODUCTION	11
4.2 MORE PROBLEMS THAN SOLUTIONS	11
4.3 DETERIORATING SERVICES.....	11
4.4 PROGRESS ON TECHNICAL STANDARDS	12
4.5 POLICY SHIFT FROM DEREGULATION TO PRIVATISATION	12
4.6 RECENT AMENDMENTS TO THE ACT	12
4.7 THE BESLEY REPORT	12
4.8 NATIONAL COMMUNICATIONS FUND	13

5. THE BROADER ISSUES OF DEREGULATIONS	13
5.1 STRUCTURAL ISSUES IN TELECOMMUNICATIONS	13
5.2 DIFFERENT MODELS OF REGULATION	14
5.3 POSSIBLE REGULATORY IMPROVEMENTS.	14
5.3.1 Access regulation	14
5.3.2 Ownership separation	15
5.3.3 Club ownership.....	15
5.3.4 Operational separation	15
5.3.5 Accounting, functional and corporate separation.....	15
5.4 THE ADVANTAGES OF STRUCTURAL SEPARATION.....	15
5.4.1 Vertical integrated companies benefits from delaying tactics.....	15
5.4.2 The Telstra Example 1.....	16
5.4.3 The Telstra Example 2.....	16
5.4.4 International benchmarks.....	16
5.5 CONCLUSIONS.....	17

APPENDIX 2

1. ANALYSIS OF THE ESTENS REPORT	18
1.1 SYNOPSIS	18
2. EVERYBODY'S HAPPY	18
3. TELSTRA OFF THE HOOK	18
4. BROADBANDING IS THE MESSAGE	19
5. WILL THE GOVERNMENT COME TO THE PARTY?	19
6. MASSIVE TASK AHEAD	20
7. ESTENS SUBSIDY SCHEME VERY COMPLEX	21
8. INNOVATION THROUGH COMPETITION.....	21
9. LONGER-TERM SECURITY	22
10. REGIONAL EQUALITY.....	23

APPENDIX 3

1. ANALYSIS - TELECOMMUNICATIONS COMPETITION BILL 2002	24
1.1 POLITICALLY RISKY MODEL	24
1.2 THE END OF DELAYING TACTICS?	24
1.3 THE EFFECTS OF THE NEW BILL ON COMPETITION	25
1.4 TELSTRA THE BIG WINNER.....	25
1.5 THE FOCUS IS ON T3 NOT ON IMPROVING COMPETITION	26
1.5.1 What Australians want	26

The Structural Separation of Telstra

1. SYNOPSIS

No other industry in Australia is so dominated by one player as the telco industry – and Telstra is one of the most dominant telcos within OECD countries. The self-regulatory regime has failed to foster real competition in the market and Telstra has been able to use the regime to its own advantage. Their ‘gaming’ and delaying tactics have resulted in a reduction of competition. This situation is bound to deteriorate even further now that Telstra not only dominates the telco industry, but, through its 50% ownership of Foxtel, has also control of the cable TV market and the key entertainment content markets (sports, movies, etc). In a more competitive environment the cable TV market could be used to stimulate competition between technology platforms, as in done in Europe and North America. Australia is the only country within the OECD where such a high-level of market dominance is permitted.

Given the incumbent’s central role in the economic life of the nation, it is appropriate for the Committee to consider a proposal that has the potential to alter Telstra irrevocably. The aim of this should be to stimulate innovation and use the telco industry as a tool to modernise our economy. As explained below, structural separation should result in a separate infrastructure business. This will create a truly open infrastructure that can be used by the wider business community, and it should produce a flurry of new business and government activities. The Estens Report has clearly indicated that ongoing long-term government involvement – along with considerable investment – is essential to the national telco infrastructure of our country. Once this is in place all other elements of Telstra can be fully privatised.

This is arguably the most important Inquiry to be held in the history of our telco industry and, as such, it deserves to be treated very seriously.

The major focus of the Inquiry should be to ensure a proper discussion – one that will produce a long-term plan for the structural separation of Telstra. But this will take time. Within the OECD the process has taken a year so far, and it will conceivably take a few more years to finalise.

There is no way that a quick and dirty Inquiry such as the one envisaged by the present government can achieve any worthwhile outcome within a few short months, when other countries are looking at a timeframe of years.

2. COMMENTS ON THE INQUIRY

I am very pleased and excited about the Australian government’s announcement of an Inquiry into the structural separation of Telstra. This is arguably the most important telco decision made by this government to date. It puts Australia right at the forefront of the international telco scene and I predict that it will lead to a watershed in national and international telecommunications policies.

The Inquiry and its subsequent follow up process should give everybody a chance to discuss this issue – and it could provide the outcome desired by consumers (business and residential), the government and the industry:

- More competition – but, more importantly, a competitive environment that is sustainable.
- An opportunity to fully privatise the content, services, retail arm of Telstra.
- Long-term security for first-class telecommunications infrastructure throughout Australia.

I am also convinced that structural separation is the best outcome for Telstra. It will allow them to focus on their businesses: the privatised business can concentrate on customer services and profits; and the network

business – linked to ongoing support of the government, as suggested in the Estens Report, should look after the national (IT&T) infrastructure and wholesale service.

The Estens Report on regional telecommunications services also clearly stated that the telecommunications infrastructure in regional Australia was the responsibility of the government, not of the industry. Estens stated this would cost hundreds of millions of dollars (our estimate \$5 billion over a 5-8 year period).

Estens clearly identifies the need for long-term government involvement in the national telecommunications infrastructure and the government can no longer ignore this issue. I conclude that the government realised that a strategic plan, as outlined by Estens, was pointing to a strategic separation of Telstra – a course of action we have strongly advocated over the last 18 months.

It is our contention that this would also improve the share price, I don't believe that, under the current vertically-integrated model, the share price will ever revert to its original price. A structurally separated company, however, will at least open the way to a different approach that might lead to a more positive development.

2.1 NETCO AND SERVCO

The process of structural separation will be a gradual one – it will certainly take several years to implement. The end result will in one form or another see a Netco and a Servco. Netco will be the infrastructure company and will retain a certain level of government ownership/involvement. Servco will be the fully privatised services company comprising all the voice, data, Internet and broadband services. Servco will operate on exactly the same basis as other telcos and ISPs. And these ISPs and competing telcos will be able to utilise the wholesale services provided by Netco on exactly the same terms and conditions.

In November 2002 Telstra instigated a very interesting reorganisation, which certainly does reflect a better alignment of the current market situation. I wouldn't be surprised if the strengthening of Telstra Country Wide and the fact that its director, Doug Campbell, also presides over Telstra's infrastructure marks the beginning of Telstra's answer to the structural separation process. There is also a real possibility that the infrastructure construction company NDC is brought back into Telstra; further strengthening the case for a viable and robust Netco.

It would be much better if Telstra took control of this process rather than once again fighting all those government and regulatory decisions over the next couple of years, wasting valuable resources and management attention. It should lead the charge and show the way forward.

All this having been said, Telstra still states that it continues to follow the model of a fully-integrated telco. However, I am interested to know what the company's stand will be now this inquiry has been announced and also now more and more financial analysts alter their position on this issue and start suggesting that structural separation might actually be a good way to add value to the share price.

Exhibit 1 – Telstra's Dominance

- No other industry in Australia is so dominated by one player as the telco industry;
- Telstra is one of the most dominant telcos within the Organisation for Economic Co-operation and Development (OECD) countries;
- Telstra has marketshares varying from 47% to 90% in any telco or pay TV market;
- The ACCC, ATUG, IIA, AIIA, SPAN, Cisco, Microsoft, Sun, HP as well as many others have warned the government about the unhealthy state of the telco industry – so far at no avail;
- Telstra unrealistically high profits are in stark contrast to the losses or at best marginal profits of all of the other major players.

3. GOVERNMENT UNDERMINING DEMOCRATIC PROCESSES?

The political reality of the Inquiry, however, became clear when the government announced its timetable. What is arguably the most important telco Inquiry ever conducted by this government will take place in only five days in February – none of them in regional Australia – and the report is to be tabled on March 24.

The government has been using the ‘Christmas trick’ for years now – announcing Inquiries to address complex telco issues just before Christmas and using the fact that people are taking holidays and so don’t have the time to generate proper submissions. It is my contention that, by doing this, they directly undermine the democratic process. The structural separation issue needs to be discussed over a full year; we have to get this right and we need as many experienced minds on the job as possible, to discuss the pros and cons. Given this ridiculous timeframe, I think a key outcome of the Inquiry should be that more investigation is required.

We have got a unique opportunity to not only get the future of our telecommunications industry and infrastructure right. We also have a opportunity to lead the world in this respect. Australia has amongst the best Regulators in the world (ACCC, ACA and ACIF) and as a side effect of a process towards Structural Separation, together with the regulators a range of intellectual property export opportunities could be explored.

It is however, frightening to observe the government’s tunnel vision. Their image of the telco world is apparent in the following comment they made about the Inquiry.

‘However, we are categorically and genuinely opposed to such an idea (ed. Structural Separation) because it would have a disastrous effect on Telstra’s competitiveness and the industry. We think the idea is just plain stupid.’

If this is indeed their view, then the government must believe that the OECD, the European Union, several European parliaments and Professor Alan Fels are stupid, since they all support the idea of structural separation. From its lofty position, the Australian government apparently believes it is the only one to get it right. But its track record proves the opposite. Competition in telco land is dying, thanks to the policies that have been implemented by the government since 1996/1997.

Its digital TV policy is the worst in the world; its privatisation policy is in shambles; its regional policy has just been shot to pieces by the Estens Report – yet they take the high ground and call everyone else stupid.

We need a government that will act like a mature governing body capable of making considered judgements about important issues.

Structural separation is inevitable; the problem is how to identify the format that best suits us in Australia and how to implement it over a 3–5 year timeframe. This government continues to try to hold back the international tide in telco-land, they continue to fight battles that they are going to lose anyway, so why not at least try to follow the overseas trend and tap into the global think tanks that are operating on a much more mature level?

- The rest of the world doesn’t privatise its telcos – only 3 out of the 30 OECD countries have fully privatised operators.
- Governments around the world consider telco infrastructure to be a national asset and accept the fact that long-term government involvement is required, at least for large sections of this network. We are still waiting to learn the government’s position on this, as requested by the Estens Report, but up till now it has flatly denied any responsibility.
- Structural separation is now also seen by the financial industry as a potentially positive move forward. It could help the government’s push for privatisation, rather than hampering it.

- Digital TV is used by other governments to promote competition between platforms. Australia can't use the benefits of digital TV until at least 2008, thanks to this government's policies.
- Cable TV is used by every other government in the western world to promote competition between platforms – Australia is the odd one out.
- Cross-media ownership (telco, cable, content) is not allowed in any other comparable country, but this government has allowed a massive monopoly to develop.

So, again I ask: who is stupid?

Why can't the government take a more mature position and genuinely try to find solutions that will help the industry and enable it to play its role in the modernisation of the Australian economy through the many innovations it has to offer? Why does the government repeatedly find itself on the back foot on telco issues?

We hold Inquiry after Inquiry, and the messages that come out of them are always pretty clear – yet the government is fighting progress every inch of the way.

4. REGULATIONS HAVE FAILED TO DELIVER COMPETITION

While I support a regulated environment I do hear what the opponents of regulation are saying, and I believe they have a case. Despite the massive investments in regulation around the globe (over 150 countries have independent telecommunications regulators), the question remains as to whether they have actually stimulated competition.

In Australia, the number of major players (revenues of over \$100 million) have decreased from 11 in 1999 to 5 in 2002 – and we haven't reached the end yet. As a result the incumbents, feeling more secure, have had the confidence to increase basic charges and continue to delay the opening up of the most essential elements of the market – data services such as leased lines and the last mile to the consumer.

Initial legislation assumed cooperation on the part of the incumbent telcos, whereas those telcos were at that stage becoming involved in the privatisation process and this produced a conflict of interest – to cooperate with the government on deregulation was against the interests of their shareholders. In fact, they went the other way. There was plenty of room in the legislation to maintain parts of their monopolies and the incumbents are making use of the more accommodating and less prescriptive regulatory environment to delay competition.

However, despite this, it is still my belief that, unfortunately, we will need to rely on regulation to stimulate competition for several years to come. However, the focus needs to shift from regulation of the market to industry regulation. As a matter of fact all changes in the Australian telco market have been regulatory driven, without government leadership Telstra will not move and instead protect its vested interests and thus indirectly hamper innovations and the modernisation of our economy.

5. TELSTRA

5.1 FINANCIAL SUCCESS STORY

Telstra has gone from strength to strength over the last twelve months. It can be justifiably proud of its recent financial prudence, which has left it in a much better financial position than many of its overseas counterparts. While I am undeniably critical of the company in other respects, I give full credit for this achievement.

5.2 SUCCESSFULLY ELIMINATED THE THREAT OF COMPETITION

Telstra has also succeeded in eliminating the threat of competition, thanks to the regime of self-regulation that has been operating over the last six years. Its major competitors, Optus and AAPT, have both retreated into niche markets. Apart from the mobile market, Optus is making a small dent in the corporate market, but otherwise neither of them poses any serious threat to Telstra. Most of the other players have either disappeared or have also withdrawn into niche markets, while others didn't ever reach the stage of becoming a threat to the incumbent. I believe the new telcos were partly to blame for this state of affairs, since the business models they elected to use were not sound.

5.3 TELSTRA IS UNTOUCHABLE

Competition certainly does have an effect on Telstra but, because of its dominant position, any losses that it incurs can easily be recovered in other areas. If they lose money in the corporate market they simply increase line rental or mobile charges in the residential market and they're back on top again. In order to protect their lucrative corporate data market they simply delayed the introduction of broadband. Despite political disruption and complaints from consumer organisations and others they never encounter any serious problems. They seem to be able to operate above the law they are untouchable.

5.4 THE STRANGLEHOLD OF A VERTICAL INTEGRATED TELSTRA

The current regulatory problems have more to do with the structure of the industry than with the individual services. The vertically integrated model protects the incumbents from competition and it allows them to maintain the inefficiencies that are embedded in such structures (adding approximately 35% to the cost structure). In a lean, mean restructured environment it is debatable whether the incumbents would be able to survive.

5.5 TELSTRA MOVING INTO THE MEDIA MARKET

Having won the battle in the traditional telco market the company is now moving into the new interactive multimedia market. It is doing this on its own terms. I can't help but admire the way they manage to do this – neither the government, nor the regulator, nor commentators and analysts can affect the process. Their biggest victory so far has been the defeat of one of their major enemies, Professor Allan Fels. For a long time Telstra had made it clear that they were not happy with the regulator and their recent 'Foxtel' victory must have been sweet indeed. They have now been given the power to dominate the next market – that of interactive multimedia.

Kim Williams has surely proven his mastership, with a very recognisable touch from Sam Chisholm, they both knew that the deal had very little to do with the dying pay TV market but that it was a strategic move into the broader interactive media market. They clearly outmaneuvered the ACCC on this issue. The ACCC was of course hampered by the fact that they had to stay within the narrow confines of the content sharing deal and couldn't take such broader issues into account.

Telstra/Foxtel will be the only telco in the world with the ability to dominate across markets:

- Traditional telco infrastructure;
- Basic telco service;
- Cable TV infrastructure;
- Key content such as movies and sport.

6. ARE DISASTERS NEEDED BEFORE WE SEE CHANGES?

The incredible management blunders made, for example, in the UK and the Netherlands have nearly led to the collapse of their national telco companies, or essential parts of them. Other high profile disaster stories include the world's largest operators AT&T and NTT. This has put back on the agenda the question as to whether it is wise to maintain the vertically integrated model.

Several European parliaments have already indicated that they might be willing to nationalise (parts of) the infrastructure. One thing is certain – the network will have to be separated from the retail organisations of the incumbents if we are ever to see competition flourishing in the market. A broadband environment, in particular, cries out for such a structure, since it would be beneficial to everybody involved if as many companies as possible were allowed to deliver their services and their content over the network, without having to be in some sort of a partnership with the telco.

Exhibit 2 – Imagine if TNT were to be the only courier allowed to use the road system

I have compared the operation of Telstra's monopolies to a hypothetical situation where the building contractors of a road system only permit access to a select number of friends and allies. First of all they would form their own transport, courier company, taxi company, bus company, limousine hire, etc. and only allow them to use the road. They would then build the trucks and cars and only these cars would be allowed to be used by people driving on that road. If you were lucky you might be able to sign a partnership deal. For example TNT signed a deal, but would have to pay a 50% share of its revenues to the road owner. And Ipec, for instance, would not be allowed to drive on the road without such a partnership agreement

I think you will agree that this would be a ridiculous situation, but our politicians and regulators seem to find it quite acceptable in the telco industry. In fact, as we speak, politicians across the board are preparing to sanction the comparable 'safe harbour' arrangements.

7. THE FALL OUT FROM THE FOXTEL DEAL

The latest 'name of the game' is the emerging interactive media market. After the Foxtel deal, Telstra/Foxtel is now in an ideal position to take charge of this wider broadband-driven media market also. Pay TV is only a means to that goal.

I am highly critical of the merger – not so much in respect of the pay TV market, which is rapidly becoming obsolete anyway – but because of the future effects that this merger will have on the broader media landscape in Australia.

The OECD evidence here is clear – incumbent telco ownership of both copper and cable leads to a slower roll-out and higher priced broadband services. Add content to this and the effect will be compounded.

The ACCC might have had very little choice other than to get the maximum number of undertakings out of the deal – and it did get these, and should be commended for doing so. My criticism is that the deal goes way beyond the pay TV deal and that there was very little that the ACCC could, or did, do about that.

The Minister also recognised the new situation and commented: *'Clearly these arrangements require consideration by the ACCC under the Trade Practices Act, and the Government will also seek formal advice from the ACCC concerning the extent to which emerging market structures are likely to affect competition across the communications sector, including through the provision of bundled Pay-TV, telephony and broadband services. The Government is keen to ensure access to content on non-discriminatory terms.'*

At face value this is very encouraging, as it would be very difficult to come to any other conclusion about the new market structure and its negative effect on the competition. The only really effective outcome would be a full structural separation of Telstra.

8. COMPETITION BILL WILL NOT IMPROVE COMPETITION

Most industry observers agree with me that, despite the Minister's strong response regarding my analysis of the effects of the recently introduced Telecommunications Competition Bill, the Bill will have very little effect on the dominance of Telstra or on competition in the telco industry. However, it could be a hook that the government could use to extend the virtual separation arrangement in accordance with the recommendations that will come out of the study that the ACCC is conducting following the Foxtel deal and ultimately pave the way to full structural separation.

While there are marginal improvements in relation to competition, the new Bill will have little or no negative effect on Telstra. There are sufficient safeguards incorporated into the Bill to allow Telstra to protect its vested interests.

The main victory for the incumbent, however, will be that it will be handed a tool to prevent anybody from using its networks. As soon as the word 'investment' is mentioned Telstra will be given a safe harbour facility that will protect it from any regulations that are developed to provide fair and equitable access to these facilities.

9. CROSS PLATFORM COMPETITION

With an eye on the ACCC investigation it is interesting to note that several times the Minister has expressed an interest in using the various media platforms to stimulate competition. The key platforms are:

- The fixed telecoms network with services such as ADSL and FTTH in the future;
- The free-to-air broadcasting platform, including digital TV;
- The cable TV platform with cable modems and set-top boxes.

The Foxtel deal certainly makes it far more difficult to create competition between services provided over telco and cable TV infrastructure, since Telstra dominates this market, and no long-term commitment to operate in this market has been made by Optus.

The digital TV policy is in total shambles, a fact that has also been belatedly recognised by the Minister. Earlier this year he tried to create an opening to revive this platform to stimulate competition, but unfortunately this failed, and it is now unlikely that anything will happen before 2008.

What I would once again like to see here is openness from the government and all the involved parties being able to address the situation in a comprehensive way. So far the platforms have only been looked at in isolation, the government refusing to allow an overall assessment. The ACCC investigation might just open up an avenue to take that broader view.

10. GOVERNMENT WILL HAVE TO TAKE A LEAD

I am enough of a realist to recognise that it is useless to try and put the clock back. The reality is that, for a long time to come, Telstra will be the dominant player across the telecoms and media markets. Australia could take a leading role in the worldwide trend towards structural separation. And we have to accept that this is going to take a long time.

Whether the government likes it or not the current political situation is such that Telstra will remain in the government's hands until the issues as addressed in the Estens Report are solved.

Estens, however, is spot-on in his report. He states that government leadership is crucial if we are to begin to move towards a knowledge-based society for all. Let's hope the government accepts the recommendation to begin to generate a strategic plan and to start directing money towards infrastructure rather than to a large number of worthwhile causes – which, at best, will have minimal impact on the long-term improvement of telecommunication services in regional and rural Australia.

Based on this reality it makes sense to start restructuring Telstra along the lines of a Netco and a Servco.

Appendix 1

1. STRUCTURAL SEPARATION UNDER DISCUSSION

In December 2001 Alan Fels launched a scathing attack on Telstra and on the powers it has, this was repeated in an article in the Australian Financial Review (AFR) in February 2002. Its army of lawyers has been able, as we have indicated on so many occasions, to delay any form of competition for more than a decade. It has successfully lobbied the government into a self-regulatory regime, which I vigorously opposed in 1996, allowing Telstra, in Alan Fels' words: to negotiate, arbitrate and re-arbitrate any decision from the regulator, causing delays of up to 7 years.

Alan Fels is supported by an OECD report that argues for structural separation, if this industry ever wants to become competitive. Microsoft fueled the debate in February 2002, with a message directed at the government along similar lines. In Europe and even in the USA the issue is clearly back on the agenda.

2. AUSTRALIAN TELECOMMUNICATIONS REGULATIONS

The second edition of the Australian Telecommunications Regulation guide, published by the Communications Law Centre in late 2001, explains the laws applying to Australian communications as at 31 July 2001. It is written for lawyers and non-lawyers and explains the laws, their implications and their policy context. The guide covers the Telecommunications Act, the Radiocommunications Act and relevant parts of the Trade Practices Act, and explains key regulatory decisions since July 1997. It features clear and informed commentary on:

- reform of Australian telecommunications regulation in the 1990s;
- industry structure and regulatory bodies;
- access and interconnection;
- anti-competitive conduct;
- spectrum licensing and allocation;
- consumer issues.

The next two chapters are from the book followed by an abstract of the speech of Professor Fels, chairman of the ACCC at the launch of the book.

3. THE POLICY CONTEXT

3.1 THE COMPLEX BUSINESS OF DEREGULATION

Australian communications companies, policy-makers, regulators and consumers are engaged in the complex task of making competition in telecommunications markets work. The *Telecommunications Act 1997* (TA) marked the third stage of reform of the country's telecommunications legislation in less than a decade. Each stage represented a further fracturing of the model of monopoly public provision of electronic telecommunications services which was used in Australia and most other countries from the 19th century. Since 1997, the industry, government, consumers and shareholders have also been transforming the country's largest company and once sole provider of telecommunications services, Telstra, from public to part-private and perhaps fully private control.

3.2 INTERNATIONAL CONTEXT

These reforms have been part of an international trend to liberalise access to telecommunications markets and privatise Telecommunications Service Providers. This trend has been encouraged by the growing importance of communications, media and information services to overall economic activity. While service industry output and employment in industrialised economies has long dominated primary and secondary industries, the emergence of an Information Economy has made media and communications services as central to economic futures as they have always been to social and cultural futures.

The international trend to emphasise competition as a primary element of economic and industrial policy has mirrored the domestic reform agenda for all Australian industries. Competition from firms at home and abroad has been seen as a vital spur to export performance and to lower prices and higher quality of service for consumers. In some developing countries, competition has been introduced to encourage the building of new networks and the provision of telecommunications services to previously unserved consumers, as part of broader strategies of economic modernisation and national infrastructure development.

3.3 TECHNOLOGICAL CHANGES

Technological change is an important part of this transformation. New technologies have made it possible to communicate and do business in different ways, and the speed and unpredictability of their development has motivated the policy emphasis on liberal markets and open competition. In particular, the Internet and the technologies developed to carry information over it, are now challenging the cost base, pricing arrangements and capabilities of traditional telephony networks.

New communications technologies and services have created possibilities to advance longstanding social policy goals. In Australia, with its small population spread across vast areas and profound political and social attachment to the conquest of distance, each major development in communications technology – the telegraph, the undersea cable, the telephone, the satellite, the Internet – has brought with it the promise of progress on this cultural task.

3.4 SOCIAL AND ECONOMIC ISSUES

By the early 1990s, the goal of making basic telephone services available to all Australians had largely been met. Up to this time, this goal had dominated Australian telecommunications policy because it was the primary justification for the existence of a monopoly Service Provider (SP). It has now given way to a more complex set of goals to provide cheaper and more diverse services to business and residential consumers through a more competitive industry structure. The social policy goal is to ensure not only that basic obligations are maintained, but that the benefits of competition flow through to all Australians. Nevertheless, the 'rural agenda' has continued to be a potent influence on telecommunications policy. On different issues, it has provided both a spur and a constraint for the broader liberalisation and privatisation agendas.

3.5 CHALLENGES AHEAD OF THE GOVERNMENT

In pursuing these policies, successive federal governments have faced major political and conceptual challenges. In particular how to make competition work in an industry;

- which requires co-operation between competing network owners to achieve 'any-to-any connectivity';
- with huge sunk costs and ongoing investment requirements;
- where the incumbent is likely to remain dominant in the provision of fixed-line access services for the foreseeable future; and

- where it is very difficult to accurately attribute shared costs incurred in providing different services;
- how to maintain social obligations in a regulatory environment which emphasises open competition as the primary driver of customer satisfaction, and the scrutiny of private shareholders as the primary incentive to company performance;
- the appropriate role for government in the Information Economy; and
- the most appropriate mechanisms for allocating access to public resources such as the radiofrequency spectrum and rights of way.

4. DEALING WITH THE CONSEQUENCES: POST-1997

4.1 INTRODUCTION

The passage of the 1997 TA was accompanied and followed by a large amount of detailed regulatory work to carry out activities specifically required by the Act and to pursue the policy goals it established. New carriers were licensed, new infrastructure plans were announced and new service providers established businesses.

4.2 MORE PROBLEMS THAN SOLUTIONS

However, industry organisations were critical of the perceived slow pace of reform. They criticised Telstra's alleged reluctance to embrace the new competitive environment in its wholesale dealings with the industry, and the ACCC's tardiness in exercising its powers to ensure a competitive marketplace. A year after the 1997 legislation came into effect, the two largest new entrants, Optus and AAPT, and the Australian Telecommunications Users Group (ATUG), wrote to federal cabinet ministers claiming that: 'Evidence abounds that (effective and sustainable competition) does not exist at present because of Telstra's dominant position in the market ... Telstra has little regard for either the letter or the spirit of existing legislation and less for regulatory bodies like the ACCC.' Telstra and its consultants argued that: 'Australia has made impressive progress toward removing regulatory obstacles to the functioning of a competitive marketplace ... Unrealistically high expectations predictably give rise to impatience and disappointment. That experience ... is not an inherently Australian phenomenon'. A series of competition notices issued by the ACCC in 1998 together with subsequent court action, saw modifications to Telstra's conduct in two areas: the provision of wholesale Internet access services and the administrative processes involved in transferring customers lost to its competitors. By 1999 the focus of competition regulation issues had moved decisively to interconnection and access issues, through the ACCC's consideration of Telstra's access undertakings, its inquiries into the declaration of particular services and conduct of individual arbitrations. The ACCC also considered, and rejected, a number of major proposed takeovers in telecommunications and related industries: Foxtel and Australis; Cable & Wireless Optus and AAPT; Telstra and OzEmail.

4.3 DETERIORATING SERVICES

Deteriorating quality of service performance by Telstra, particularly in the context of the Government's commitment in early 1998 to privatise the remaining two-thirds of the company, saw changes to the CSG scheme and further reviews and recommendations to improve its effectiveness. The submission late in 1998 by Telstra of a claim for the net cost of its universal service arrangements, which massively exceeded the previously accepted cost, raised fundamental questions about the appropriateness of the existing universal service scheme and the methodologies for costing it.

4.4 PROGRESS ON TECHNICAL STANDARDS

The ACIF made considerable progress with the development of industry codes covering technical issues, including a complete review of AUSTEL technical standards for customer equipment and cabling. Progress with the development of consumer codes was slower initially, but accelerated from 1999.

4.5 POLICY SHIFT FROM DEREGULATION TO PRIVATISATION

The Coalition Government, re-elected in October 1998 with a reduced majority in the House of Representatives and a Senate where the balance of power would shift to the Australian Democrats from July 1999, committed itself to privatising at least another 16.6% of Telstra. The remaining 50.1% would be sold once an independent review team was satisfied that Telstra's quality of service performance had improved sufficiently. The Coalition also agreed to tighten service standards under the CSG, to give the Australian Communications Authority (ACA) a power to direct carriers to undertake specific action in the event of systemic quality of service problems, and to include a digital data capability in the statutory universal service arrangements.

4.6 RECENT AMENDMENTS TO THE ACT

In mid-1999, a substantial package of amendments to telecommunications was passed by the Parliament, including:

- *Telecommunications Legislation Amendment Act 1999*;
- *Telecommunications (Consumer Protection and Service Standards) Act 1999* (TCPSSA);
- *Telstra (Further Dilution of Public Ownership) Act 1999* (which had been the Telstra (Transition to Full Private Ownership) Bill 1998); and
- *Telecommunications Laws Amendment (Universal Service Cap) Act 1999*.

These Acts provided for the further part-privatisation and eventually full-privatisation of Telstra, in line with the Government's election commitments. They also provided significant new powers for the ACCC in regulating anti-competitive conduct and handling access disputes and capped the net cost of universal service arrangements at its 1997/98 level (adjusted for inflation) for the next two financial years. The telecommunications-specific consumer protection provisions in the 1997 TA and the price control provisions from the *Telstra Corporation Act 1991* were shifted into the new TCPSSA, where they were supplemented by new provisions about telephone sex services (Pt 9A) and a very wide power for the Minister to direct Telstra to ensure its compliance with the Act (Pt 10). In two separate pieces of legislation passed in 2000, the universal service arrangements were first modified, then completely overhauled, particularly to introduce a greater level of contestability.

4.7 THE BESLEY REPORT

The second tranche of shares in Telstra was sold in the second half of 1999, bringing private shareholding to 49.9% of the company's capital. The Government's inquiry into Telstra's service levels (Telecommunications Services Inquiry) reported in September 2000 (Besley Report), concluding that 'Australians generally have adequate access to a range of high quality, basic and advanced telecommunications services comparable to the leading information economies of the world'.

It found that Australians who live in metropolitan and regional centres enjoy good telecommunication services and are generally satisfied with them. However, a significant proportion of those who live and work in rural and remote Australia have concerns regarding key aspects of services which, at this stage, are not adequate. Their concerns relate primarily to:

- the timely installation, repair and reliability of basic telephone services;
- mobile phone coverage at affordable prices; and
- reliable access to the Internet and data speeds generally.

Continued development of competition, together with initiatives such as contestability in universal service contestability, would 'materially improve the services available to rural and remote consumers'. However, the Besley Report also made a series of recommendations to address the areas of concern it identified. It made no specific recommendation about the further privatisation of Telstra.

4.8 NATIONAL COMMUNICATIONS FUND

In May 2001, the Government responded to the Besley Report recommendations, committing \$163 million for initiatives including a National Communications Fund to assist significant regional telecommunications projects in education and health services, improved mobile phone coverage and dial-up Internet access, increased consumer representation and a study and action plan about the telecommunications needs of remote indigenous communities. It also announced that it would: reduce the maximum connection time for remote telephone services; direct the ACA to implement a revised quality of service reporting framework for all major SPs and to review the operation of the CSG in a multi-carrier, multi-platform environment; and that it would appoint a member of the ACA with specific responsibility for monitoring and investigating quality of service issues, especially regional, rural and remote issues. While including revenue from the sale of the Government's remaining stake in Telstra in forward estimates published with the 2001/02 budget, the Government indicated that: 'The Coalition's position on Telstra is crystal-clear – we will not take any steps to privatise any more of Telstra unless and until we are satisfied services are adequate.'

In June 2000, the Treasurer directed the Productivity Commission (PC) to undertake the review of the telecommunications-specific competition provisions in the TPA and the TA required by the TPA. Although the TPA requires this review to be undertaken by mid-2000, the PC Draft Report was published in March 2001, with the final report due in September 2001. The Government announced a number of amendments to the ACCC's arbitration process in June 2001, which it said were consistent with the PC Draft Report. The intention was 'to provide certainty for critical investment by Telecommunications SPs and to promote the rapid development of broadband services.'

5. THE BROADER ISSUES OF DEREGULATIONS

At the launch of the book Professor Alan Fels, chairman of the ACCC analysed the regulatory market on the eve of 2002. The following is an abstract of his speech.

5.1 STRUCTURAL ISSUES IN TELECOMMUNICATIONS

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

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

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

- perhaps we need to consider how we regulate the telecommunications industry from the perspective of industry structure, rather than access alone;

- and that our regulatory reference point could be the market power of the incumbent.

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

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

5.2 DIFFERENT MODELS OF REGULATION

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

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

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

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

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

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

This description largely fits the Australian telecommunications industry:

- although in Australia we have a relatively unique situation whereby the owner of the local loop is also a 50% shareholder in the major pay television cable network.

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

5.3 POSSIBLE REGULATORY IMPROVEMENTS

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

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

5.3.1 Access regulation

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

Other approaches, which involve various models of separation include:

5.3.2 *Ownership separation*

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

5.3.3 *Club ownership*

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

5.3.4 *Operational separation*

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

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

5.3.5 *Accounting, functional and corporate separation*

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

5.4 THE ADVANTAGES OF STRUCTURAL SEPARATION

5.4.1 *Vertical integrated companies benefits from delaying tactics*

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

...the need for regulation that is difficult, costly and only partially effective ...it reduced the incentive of the provider of the non-competitive activity to restrict competition in the competitive activity.

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

An integrated firm, in contrast to a separated firm, benefits from any action which delays the provision of, raises the price or lowers the quality of access. An integrated firm will therefore use whatever regulatory, legal, political or economic mechanism in its power to delay, restrict the quality or raise the price of access. Furthermore, the integrated firm has strong incentives to innovate in this area, constantly developing new techniques for delaying access. Although the regulator can address these techniques as they arise, it is likely to always be 'catching up' with the incumbent firm. Regulation, despite its best efforts, is unlikely to be able to completely offset the advantage of the incumbent.

5.4.2 *The Telstra Example 1*

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

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

This could be interpreted in two ways:

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

5.4.3 *The Telstra Example 2*

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

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

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

5.4.4 *International benchmarks*

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

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

Additionally, a recent Macquarie Research Equities publication found that:

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

5.5 CONCLUSIONS

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

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

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

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

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

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

Appendix 2

1. ANALYSIS OF THE ESTENS REPORT

1.1 SYNOPSIS

Estens has lobbed the T3 ball squarely into the government's court. Telstra may be off the hook but Estens has unquestionably pointed the finger at the government. If they are serious about addressing the Report's thirty-nine Recommendations (23 of which require a government initiative and only 16 a Telstra initiative) they will have to come up with both a Strategic Plan and billions of dollars of funding. Up till now the government has refused to take responsibility for the funding of regional telecommunications infrastructure and they have also refused to allocate money from T3 towards such a fund.

2. EVERYBODY'S HAPPY

The government is happy with the outcome of the Estens Inquiry; Telstra is happy; and I, also, am happy. How can this be?

The reason is that, as usual, we are all looking at different aspects of the Report.

- The government is happy because the Report shows that the telephone service in the bush has improved, and they believe that this is all that has to happen for them to be able to privatise Telstra.
- Telstra is happy because the report doesn't require them to begin funding new regional telecommunications broadband services.
- I am happy because the Inquiry unambiguously spells out what needs to be done in order to broadband regional Australia and it places the total responsibility for this squarely into the hands of the government.

I have said many times that the focus should be shifting from voice services to broadband and more than half of the Report focuses on this issue. It has been my contention for some years that what is needed is a vision from the government rather than a haphazard approach, and the Inquiry calls for a Strategic Plan.

It is also important to recognise the fact that, contrary to the government's belief, Estens does not express support for privatisation. The Report states: '*The Inquiry has no view on the future of Telstra....*'

Also, notwithstanding the feelings of satisfaction evoked by the Estens Report, the fact remains that more than 600 of the 606 submissions were of a negative character. Although the Report doesn't articulate this negativity, it is nevertheless evident from the issues that have been plainly identified as being of concern.

At second reading, however, a more complete understanding of the implications of the Estens Report began to dawn on the government. It realised that it put the full privatisation of Telstra a long way up the road ahead. It immediately appeared to get cold feet and began to use the unfavourable financial market situation as a possible reason for dropping its T3 policy.

3. TELSTRA OFF THE HOOK

Ever since I instigated my 'Broadband Campaign' in 1999 I have maintained that government support would be necessary to broadband Australia, and that it would be unreasonable to expect Telstra to pay for the upgrading of economically unviable sections of the infrastructure in regional areas. Since then it has become clear elsewhere around the world that as much as one-third of the network that needs to be

upgraded for broadband in developed countries will require some form of government subsidy. In Australia, we have estimated these costs to be around \$5 billion.

Telstra's Country Wide received a special mention in the Report; it was commended for the progress it has made so far. However, the division was initially set up by Telstra as a political vehicle to appease the government and Estens now wants assurances and some formal commitments from Telstra to strengthen Country Wide to ensure that they will be able to continue their excellent work. I am sure that this requirement will be welcomed by the Telstra Country Wide group.

A more problematic – and a more costly – issue will arise for Telstra when it seeks to address the recommendations requiring it to sort out its pair gain problem and its expensive ISDN charges.

It is also interesting to note that a lot of the improvements made by Telstra have been instigated by government intervention – such as the Estens Inquiry. Clearly, a more long-term strategic policy is needed for regional areas, to replace these ad hoc measures.

4. BROADBANDING IS THE MESSAGE

It was encouraging to note that in the Report Estens frequently alludes to the importance of broadband. *'Access to higher bandwidth services is becoming vital for the economic and social developments of regional, rural and remote Australia'* (Finding 6.1). Further on there is mention of *'[its] critical importance to the information economy'* and the fact that *'higher bandwidth service is becoming vital for economic and community growth'*.

Of course, we have heard all this before. But Estens doesn't stop there as so many others have done – just paying lip service. They have come up with possible solutions, and, while I question some of their proposals, this doesn't diminish the fact that they have had the initiative to formulate real solutions.

To be fair, the government has in recent months attempted to bring Australia into the global broadband arena. But so far the government initiatives have been half-hearted – and we haven't heard a lot from the BAG (Broadband Advisory Group) either. Let us hope that the BAG becomes revitalised by this Report and begins to assume a more significant role.

The strong approach taken by Estens is what the BAG should have adopted months ago. But perhaps this will be the shot in the arm the BAG needs to get moving. They were nervous about taking a more visionary approach and actually fleshing out some broadband policies. The BAG could take up the Report's suggestion of a Strategic Plan and develop a national plan – of which the regional plan will be an integral part. It appears to me that a great deal of the effort expended by the BAG has gone into marginal tweaking, plus the odd feel-good content and services initiative. The focus, however, should be on infrastructure.

5. WILL THE GOVERNMENT COME TO THE PARTY?

It will be very interesting to see how the government reacts to the recommendations. It indicated that it had sent them to Telstra for comment, but Telstra's part will be relatively easy. There are, of course, several areas that need special attention – especially in the Internet (technical standards) and ISDN (pricing) areas. But none of these would cause them major concern.

The bulk of the recommendations are directed at the government. Estens is very explicit here and clearly states that the industry should not have to assume the financial burden of broadbanding regional Australia. As we have stated many times, this is an economic and social issue and needs to be addressed via government policy, not as an industry initiative.

To date, the government has flatly refused to take any responsibility for the funding of regional broadband infrastructure and it has also clearly stated that it will not allocate any of the proceeds of the sale to a telecommunications fund. It will be very interesting to see how they are going to resolve this. The Report does not put a figure on the costs, but it does suggest that it will run into the hundreds of millions. I assume this to be an annual figure, although this also isn't actually expressed in the Report.

As mentioned above, our estimate is \$5 billion – over a 5-8 year period. The Inquiry believes that a trust fund is an effective mechanism for the funding. This proposal came from a suggestion by ATUG, which I fully support.

There is nothing wrong with such a large scale government funded infrastructure investment. National infrastructure in general requires long-term funding as it will provide long-term benefits. For example I predict that the next fibre-based infrastructure will last for at least the next 20 to 25 years.

In order to ensure that the government clearly understands the importance of the Report, Estens states: *'The Inquiry believes that the Government should respond to these future challenges carefully, and in accordance with the principles outlined in this Inquiry. Failure to do so could ultimately reduce service benefits for those regional, rural and remote consumers who the Government aims to assist'*.

Is that clear or isn't it?

6. MASSIVE TASK AHEAD

And Estens doesn't stop there. The Report goes into quite a lot of detail on how to proceed. It indicates that a Strategic Regional Plan will need to be developed, bringing together all the various elements required for the broadbanding of regional Australia:

Exhibit 3 – Strategic Regional Telecommunications Plan

To underpin and support the review process, the Inquiry considers the Government should establish and maintain a strategic plan for regional telecommunications. Such a plan could set out Government objectives in relation to regional telecommunications, as well as strategies, programs and projects, regulatory arrangements, funding commitments and timeframes for achieving objectives. It would have a key focus on strategies for providing new services under future-proofing initiatives, but could also cover other key areas of policy priority, such as services in remote Indigenous communities, awareness and training, and demand aggregation strategies, to take a number of current areas of policy focus.

(Source: Estens Report)

It proposes a subsidy per customer in areas that need to be broadbanded with government assistance. In order to begin to consider this plan the government will first need to identify these areas – something we have long argued for, since previous government grants (close to \$1 billion's worth of them) appear to have been given out fairly indiscriminately.

According to the Inquiry, these per-customer aggregated subsidies could then be used by access providers to build broadband networks in these areas.

This will be a tedious process and could easily take a year to develop to the implementation stage. It will be interesting to see if the government accepts the fact that it needs a Strategic Plan in the first place, and then to see how quickly it can implement it in order to safeguard its privatisation process. I am sure that the Parliament – and certainly the Senate – would like to see this happen before they vote on T3.

I can't see that this Report has alleviated any of the concerns that have been voiced by the Opposition parties and, despite a positive scorecard for Telstra, I can't see that the Report has improved the government's chances for T3.

7. ESTENS SUBSIDY SCHEME VERY COMPLEX

While the per-customer scheme looks pretty straightforward, I am afraid it will actually be far more complex than it appears to be in the Report.

One of the main reasons for this will be the fact that different customer and environment topologies will need different subsidies. This means that, to attract operators that are willing to build new infrastructure, a large sum of aggregated money will need to be made available at the start. This means that, in some areas, a very high subsidy will be required to reach a basic level of the financing necessary for such a roll-out.

I wouldn't like to have to sort all of this out. Certainly, the process should be aimed at achieving results that are fair and equitable, but I question whether it will actually be workable. Infrastructure projects are large-scale investment-hungry undertakings and a broader scale approach may be required.

Estens further complicates the scheme with the suggestion of offering different subsidies for different broadband speeds. Considering the speed with which technologies change, these specifications could become obsolete before they are even implemented.

In my opinion, any subsidies should be based purely on infrastructure – and this infrastructure should be future-proof.

There will be a mixture of infrastructure required: Fibre-to-the home, fixed broadband wireless and satellite. Infrastructure plans need to be addressed on a large scale and major players will be able to take advantage of economies of scale to mix and match infrastructure in accordance with customer and environment topology.

I still question whether it wouldn't be better to consider a structural separation of the infrastructure and to put a national infrastructure plan in place that can address the issue on that level. This could still involve regional facilities-based infrastructure providers, but they would have to operate around one national plan. We already have a Country Wide company and they could become the engine behind such an approach.

8. INNOVATION THROUGH COMPETITION

The Report also clearly advocates that the way forward in regional Australia will have to be based, as far as possible, on competition.

In subtle ways, and without criticising the government outright, Estens pinpoints the various problems that exist in the market. The Report bluntly states that '*contestable USO pilots have yet not delivered competitive outcome*'. It also indicates that government policies should be technologically- and platform-neutral. Well, look at the present government's digital TV policies. Not only are there different rules for different platforms – within the digital TV platform there are different rules for technologies, such as multichanneling, interactive TV, datacasting etc. Add to this the current Foxtel affair and it is evident that, if anything, government policies are tending to shift further away from the pro-competitive recommendations and observations contained in the Estens Report.

It will be a brave body of people that undertakes to straighten out this mess and change these government policies so that they will stimulate competition.

Furthermore, Estens stresses the need for competition, but this is exactly what the current regime has failed to deliver. There is now less competition than in 1997, when the new Telecommunications Act was introduced.

9. LONGER-TERM SECURITY

The Report also goes into comprehensive detail in addressing long-term requirements to secure ongoing improvements and ongoing reviews about regional issues. In many of the recommendations words like 'timeframes', 'monitoring' and 'public reports' appear frequently.

The recommendations 9.1 to 9.6 spell this out:

- *The government should put in place a process to regularly review telecommunications services in regional, rural and remote Australia, and to assess whether important new service advancements are being delivered equitably in those areas.*
- *The review process should be linked to a strategic plan for regional telecommunications, and underpinned by ongoing arrangements that provide a high degree of certainty that government funds will be made available to support service improvements in regional, rural and remote Australia, where they will not be delivered commercially within a reasonable timeframe.*

Establishing a structure for future reviews of regional, rural and remote telecommunications services should:

- *provide certainty for regional, rural and remote communities;*
 - *ensure that reviews are independent from executive government;*
 - *allow for flexible and appropriate policy responses to meet the range of needs in regional, rural and remote Australia; and*
 - *promote competition and commercial service delivery as the most effective and sustainable service outcome.*
- *The scope of regular reviews of regional, rural and remote telecommunications services should be flexible, but there should be a core focus on assessing whether important new telecommunications services are available equitably across Australia.*
 - *Future governments should be legally obliged to respond publicly to the recommendations of future reviews, and to justify responses that are not in accord with review recommendations.*
 - *The government should provide funding for future service improvements in regional, rural and remote Australia, rather than imposing financial obligations on industry.*
 - *The government should ensure that regular reviews of regional telecommunications services are supported by organisational arrangements that provide a strong focus on monitoring and assessing regional, rural and remote service levels. The Australian Communications Authority would be an appropriate body to undertake this function.*

Estens sees a major role for the ACA in this process, with new powers and new tasks, and I can only support their recommendations and views in that respect.

This, together with adequate long-term funding, would provide a framework to protect the continuing security of the regional telecommunications infrastructure.

10. REGIONAL EQUALITY

Estens also addressed the issue of the '*deep felt concern about the need for equity between regional and metropolitan Australia*'. While the Report advocates in general terms that broadband services should be available on an equitable basis in metro and regional Australia, it does not say that these services need to be identical. This points to some of the issues raised by the critics who have been asking why we should bother about the bush, as these people can't expect to get services at a city-level.

Appendix 3

1. ANALYSIS – TELECOMMUNICATIONS COMPETITION BILL 2002

1.1 POLITICALLY RISKY MODEL

There will be no legislated virtual separation under the proposed Bill. The Minister, not the regulator, will dictate to the ACCC what sort of accounting separation information should be disclosed by Telstra to facilitate the regulator in the arbitration process.

Through a 'Disallowable Instrument' the Minister will direct the ACCC to request data from Telstra on a range of issues, such as prices, terms and conditions. But the legislation doesn't automatically provide increased transparency on how Telstra's internal pricing-setting regime works. In fact, it could be argued that, by leaving the important decisions in the control of a politician, rather than in the hands of an independent body like the ACCC, the situation has deteriorated.

Everything will depend on the willingness of the Minister to use the 'Disallowable Instrument'. In theory, these Ministerial determinations could be used to close off these loopholes. The other option is to rely on 'black letter law' – and this has, in the past, enabled Telstra and its lawyers to find loophole after loophole.

Of course, this process is open to political abuse. The Minister will be lobbied from all sides – his political colleagues, the Opposition, Telstra and the rest of the industry. So, while the intention might be correct, I have reservations about the practicality of the process.

With Telstra's successful history of influencing government decisions, this legislation will certainly please the financial market and will open the door to a strong share price, since it allows Telstra to retain its position of influence.

The only real solution would be to introduce much tougher legislation. This has happened in the European and North American countries, where the incumbents operate under far tougher, arm's-length dealing rules in respect of their retail and wholesale divisions. These rules are quite explicit and leave very little room for loopholes. In the self-regulation environment that exists in Australia it is necessary for the ACCC to test every single power it has – and they clearly don't have the resources to do this. In every other industry in Australia much tougher anti-discrimination laws and anti-trust laws are in place. Why isn't this the case in the telecommunications industry also?

I had hoped that the Minister would have included some of these options in his new accounting separation legislation.

In summary the proposed legislation asks the parties to accept the bill in 'good faith'. Under the new Bill Telstra will be able to continue to 'game' the regulatory regime. There are no indications that Telstra would want to abandon this; it would not be in its self-interest. But even if we put all of this aside the new Bill will only marginally improve competition.

Full structural separation as is under discussion in Europe is the only way to create significant changes that will result in improved competition.

1.2 THE END OF DELAYING TACTICS?

The major advantage of the new legislation will be that Telstra can no longer indefinitely delay the implementation of regulatory decisions. Its right of appeal to ACCC arbitration will be removed.

I was amused to see Telstra complaining about the fact that the ACCC will now have more powers to set wholesale prices. Telstra has had six years to provide a better service to its customers and has failed to do so, despite numerous warnings from the Minister, the regulator, the Parliament and the Senate. So yes of course by them failing to come to the party, Telstra will no longer be able to do what it wants and it is good to see that the ACCC will soon be able to intervene in processes that Telstra has successfully stalled for years.

The new legislation also sets benchmarks for far more transparent pricing principles – this, also, has been a very contentious issue.

While these issues are certainly set to improve, the Bill leaves sufficient loopholes open for Telstra to continue its ‘gaming’ practices.

1.3 THE EFFECTS OF THE NEW BILL ON COMPETITION

These positive elements will mainly benefit companies such as Primus and MCT, since they are still very active in the resale area and still depend to a great extent on Telstra’s cooperation. However, in the overall scheme the effect will be marginal as we talk here about companies representing only a few percentage of the telco market.

Optus and AAPT have already largely abandoned this market. It will certainly make what is left of their existing resale business more viable. It is however, highly unlikely that the dozen or so companies that have left the market over the last few years will re-enter it. It is also unlikely that the current players will step up their resale activities to any degree. The new Bill will not lead to increased competition.

The world has moved on and this is pretty much a retrograde step. It would have made a difference if these measures had been introduced in, say, 1998/1999 when the competition was fighting strenuously for a better regime.

Having said this, anything that promotes competition is welcome – but it will have very little impact on the overall state of competition in the market. This is why Telstra has been so quiet on the subject. They are not making their customary objections to the reforms; they are pretty relaxed. They have already won the battle and are quite content to let the others mop up the left-overs.

1.4 TELSTRA THE BIG WINNER

Not only has the foreshadowed legislation been watered down – Telstra has also been granted a whole range of other concessions:

- Safe harbour – before Telstra makes new investments it can ask the ACCC not to declare their services and leave them unregulated.
- All declared services have a sunset clause of five years, after which time the whole process is wide open again.
- The ACCC is also required to warn Telstra of upcoming competition notices.

The safe-harbour issue is of particular importance, as it will also provide Telstra/Foxtel with the opportunity to block others access to its planned digital cable TV network. This part of the Bill would mean an enormous increase in Telstra’s monopoly and a severe set back for competition in Australia.

1.5 THE FOCUS IS ON T3 NOT ON IMPROVING COMPETITION

While the new Bill offers some improvement on the previous regime it is certainly not enough to revive competition in the industry and this after all was the whole purpose of the exercise. Therefore I can only conclude that this untenable situation exists in Australia because of the proposed sale of T3. I realise that the Minister is in an awkward position here. The Prime Minister has one goal only – to sell T3 at all costs, in order to secure a new term for his government. And he has told his Communications Minister to do whatever is necessary to fetch me the \$30 billion.

As well as this, Telstra is breathing down the Minister's neck, watching his every move.

The Minister is indeed firmly wedged between a rock and a hard place, and I feel a certain amount of sympathy for him in this unenviable position. However, we should not lose sight of the real issue, which is to secure a first-class telecommunications environment in Australia – one that will benefit both our society and our economy.

1.5.1 What Australians want

If the government did have the national interest at heart it would have listened to what its voters want:

- **Better prices**

Telstra is cleverly using its opaque price-setting regime well beyond the industry, and this delivers a negative effect to end-users. The Price Control Determination in 2000 was introduced in good faith, in the belief that Telstra's rights of rebalancing would be implemented according to the spirit of the legislation. The opposite is in fact happening. For example, the company has increased its line rental charges and now offers a range of totally non-transparent call charges, supposedly rebalancing the increases. Residential and business, fixed line and mobile charges have all gone up. It is clear that the end result is a lot of extra money for Telstra (\$100 million-plus) and this is obviously being paid for by the end-users.. Without appropriate regulation, prices will increase significantly post-privatisation (airport fees are a case in point).

- **Broadband for regional Australia**

To date, the government has refused to consider the funding of the \$5 billion required for new broadband infrastructure for regional Australia. Where is their vision; where is their framework for a first-class regional infrastructure?

- **Improved competition**

Everyone agrees that competition has diminished since deregulation was launched by this government in 1997 and this new legislation will do nothing to improve that situation. ATUG and various business groups have constantly alerted the government to the concerns voiced by their business members about the lack of effective competition in mobile, broadband and fixed services. This needs to be fixed before privatisations.

- **Rejection of privatisation**

According to a survey in *The Australian*, 66% of the population doesn't want privatisation and ATUG has indicated that an increasing number of their business members are opposed to privatisation.

The current telecommunications policies are totally driven by greed and the government has taken an extremely arrogant position, ignoring the wishes of its voters. And, while I believe that the Minister is sincere in his commitment to the industry, I think he is faced with an uphill battle against the expediency that is the driving force elsewhere in the government.

Bucketty, January 2003
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