

Chapter 5

Regulatory and competition issues

5.1 While previous chapters have examined the two key functions of the Australian telecommunications network – to provide voice and data services – on the basis of the available technology, the state of the network, and Government programs intended to improve access, in this chapter the Committee will explore some regulatory and competition issues. Once again the prominence of Telstra's role has skewed the discussion in this chapter towards its operations, despite the fact that it is only one of several infrastructure suppliers.

Customer Service Guarantee

5.2 The Customer Service Guarantee (CSG) is intended to provide customers with an automatic remedy if their telephone service suffers from a fault which is not rectified within certain timeframes. Occasionally disruptions to telecommunications services affect a significant number of customers in a particular area. Where the cause of that disruption is beyond a carrier's control, such as a major cable being inadvertently damaged by a roads contractor, the carrier can be relieved of its obligations under the CSG in relation to the time taken to rectify faults in the supply of services. This also automatically relieves the carrier of the requirement to make compensation payments under the CSG if it is unable to restore services within the timeframe set out in the CSG. These events are generally described as mass service disruptions (MSDs).

5.3 The loss of phone service can have quite dramatic consequences for consumers, especially businesses:

I represent 18 companies in close proximity to Albion Park Rail on the Princes Highway. On 7 February 2002, the telephone services were severely disrupted for a period of 13 days. Seventeen to 18 businesses in close proximity to our premises were severely affected, and a domestic house on the opposite side of the street were also disrupted. Trying to operate a business with a mobile phone is not the most ideal situation. This disruption resulted in the loss of revenue, our auto banking facilities such as cheque, savings and bankcard facilities, fax modem facilities and sales, and the convenience of sending and receiving orders. We were unable to offer our service and communications through our sales department, losing more than 700 calls.¹

5.4 Several witnesses were concerned about the process of MSD declarations, including the absence of publicly available, clearly defined, criteria setting out what

1 Mrs Brenda Lenhart, M & M Ceramics Pty Ltd, Committee Hansard, 11 October 2002, p 4.

constitutes an MSD. In the absence of such documentation, suspicions were voiced that Telstra is excessively resorting to MSDs as a means of bypassing the requirements of the CSG:

... it is our opinion that they are using this [MSD] as a means of bypassing their CSG obligations; therefore, they are saving on compensation. It is a means of denying Tasmanians their rightful access to a reliable telecommunications service by way of putting the necessary capex into the ground.²

5.5 Some witnesses considered that Telstra too frequently blamed the weather for MSDs when factors within its control were responsible. Several union representatives suggested that the majority of recent MSDs could be traced to inadequate maintenance and investment:

Our submission is that the cable network is deteriorating, particularly the older air cord cable, and this is largely due to a lack of maintenance. The situation that was referred to in the previous submission [an MSD at Albion Park] was, we are informed by our members, avoidable and should not have happened in normal circumstances.³

Right now we have mass service disruption and, in the view of the union in New South Wales, the only reason for that is the lack of investment over the last few years in the Telstra network. Had that not been the case, we would not be seeing this number of faults in the network each time it rains.⁴

There is more capital rationing happening at a time when more capital investment is required. That is the broad difficulty.⁵

On the one hand, you do have to make allowance for extraordinary events; I think that is not unreasonable. But on the other hand, the mass service disruption mechanism can mask, as we believe it does, a more fundamental problem with the infrastructure. It should not be the case ideally that when it rains you get a whole lot of faults because your cables are in a state of disrepair.⁶

2 Mr Graeme Sturges MP, Past State Secretary, Communications Division, Communications Electrical and Plumbing Union, Committee Hansard, 24 April 2003, p 382.

3 Mr Ian McCarthy, Secretary, New South Wales Telecommunication and Services Branch, Communications Electrical and Plumbing Union, Committee Hansard, 11 October 2002, p 14.

4 Mr Shane Murphy, New south Wales Branch Organiser, Communications Division, Communications Electrical and Plumbing Union, Committee Hansard, 19 May 2003, p 749.

5 Ms Rosalind Eason, Senior National Industrial Research Officer, Communications Electrical and Plumbing Union, Committee Hansard, 26 November 2002, p 81.

6 *ibid.*, p 70.

5.6 Other witnesses pointed to deficiencies in Telstra's management practices as contributing to the number of MSDs. These included staff cuts, increased reliance on contractors rather than full-time employees and the concentration of expertise in Melbourne:

I am aware that between Helensborough, at the northern end of the region, and Albion Park over the last four years the technical staff have been cut by 53 per cent; I am advised from 150 to 70 technicians.

...I think the rationalisation of staff and not having a central core to deal with these problems on a region by region basis exacerbates the problem when breakdowns occur.⁷

With Telstra getting rid of all the staff, the maintenance has fallen over. The main cable problem is that Telstra have contracted out to a company called NDC, which is an arms-length company of Telstra, to provide the cable pressure systems that keep these main cables under pressure and the numbers they use in them are inadequate. That is where the problem is: the air flows in these main cables.⁸

They centralised all the maintenance to one area is a great engineering achievement, in some ways. It took out a lot of expertise from the capital cities – Sydney and Adelaide. All the capitals except Hobart, had their own technical experts available. They were all centralised to Victoria...I reckon it was a very bad thing to do. They made a lot of savings allegedly. A lot of good people, who had all the expertise, did not want to go to Melbourne so they left the company. It did provide a great source of highly qualified technical staff for Vodafone and the other companies.⁹

5.7 It was also suggested that Telstra is concentrating its maintenance efforts on quick fix, band aid solutions at the expense of major networking structural problems. This approach shows positive levels of CSG compliance, arguably to boost the case for privatisation, but increases the potential for MSD declarations because it directs attention away from more significant, underlying problems:

Because Telstra has become focused, for political reasons, on getting the CSG figures to a certain level – because we know that they are supposed to be a trigger for further privatisation – it has led to a rather one-sided focus on a certain form of performance, which can have an adverse effect on actual maintenance. Employees are encouraged to get the quick fix at the

7 Ms Jennie George MP, Federal Member for Throsby, Committee Hansard, 11 October 2002, p 8.

8 Mr Steve Dodd, Union Organiser, Communications Union Branch, Communications, Electrical and Plumbing Union, Committee Hansard, 11 October 2002, p 15.

9 Mr Collin Cooper, National Vice-President, Communications Electrical and Plumbing Union, Committee Hansard, 26 November 2002, p 73.

maintenance level in order to get those time frames right for the CSG, and that means that everything is fine with the employees' productivity and performance and the local manager's performance. But that quick fix is not addressing the basic maintenance problem, and that is what we saw in the Boulding incident.¹⁰

5.8 Another concern was the inadequate warning of the declaration of an MSD:

So people were not warned at the start of it, [MSD at Albion Park] but Telstra was saying that it was a problem with wear and tear and water. It was only after some several days and weeks that they [constituents] were finally advised that it was an MSD. That is why I contend that they hid behind that to obscure some of the other issues that went to the source of the problem.¹¹

Telstra response

5.9 In evidence provided to the Committee, Telstra set out its criteria for determining when a MSD has occurred and its management and compliance processes for dealing with MSDs.¹² It also advised the Committee that:

Following the government's amendments to the telecommunications carrier licence on 15 May 2002, Telstra has developed and enhanced the criteria used to assess eligibility for CSG exemption declaration. This has included a much shorter time frame for notifying ACA, TIO and customers.¹³

5.10 Telstra pointed out that the Australian Communications Authority (ACA) has not expressed concern with the way in which the MSD notices are issued:

Telstra has not had any feedback from the ACA that has indicated any fundamental problems with the way in which Telstra has issued MSD notices.¹⁴

10 Mr Rosalind Eason, Senior National Industrial Research Officer, Communications, Electrical and Plumbing Union, Committee Hansard, 22 November 2002, p 76.

11 Ms Jennie George MP, Federal Member of Throsby, Committee Hansard, 11 October 2002, p 10.

12 Telstra, Submission 107c, pp 6-7. See also Committee Hansard, 7 August 2003, p 949 and Submission 107b, pp 8-9.

13 Mr Anthony Rix, Head, Service Advantage, Telstra, Proof Committee Hansard, 7 August 2003, p 948. See also Submission 107b, p 7.

14 Mr Anthony Rix, Head, Service Advantage, Telstra, Proof Committee Hansard, 7 August 2003, p 849.

5.11 Telstra explained that all of its repair and maintenance work, whether undertaken by Telstra staff or by contract labour, was subject to strict quality controls. As an example, it set out its minimum standards for temporary repairs as follows:

The minimum standard for temporary repair of a phone service is to provide the customer with the ability to make and receive telephone calls. In making a temporary repair, consideration is made of any safety hazard associated with the solution and the risks of future failure of the customer's service. In the case of a customer with a disability service the temporary repair will allow them to use their existing teletype.¹⁵

5.12 Telstra disputed claims that contractors are paid significantly less than Telstra's permanent staff for comparable work:

Benchmarking between Telstra service and contractors shows that there is not generally a significant difference in cost for installation and maintenance costs. Without detailing the rates, the difference is largely due to the different activities.¹⁶

5.13 It explained that contractors' work is monitored for quality and did not dispute union claims that only one in ten jobs, on average, is inspected:

Telstra undertakes contract inspections in accordance with Australian Standard 1199. The Australian Standard takes an approach based on sampling completed work. The standard sets out sample sizes based on the volume and type of activity that ensures high levels of statistical validity. A one in ten sampling rate is typical.¹⁷

5.14 Telstra also did not dispute the union claim that staff numbers have decreased but maintained that levels of service had not been affected:

As I advised the Committee in May, a combination of the significant upgrading of the technology used in the Telstra network, the delivery of a more robust network through better targeted programs and improved work practices has created a situation where fewer staff are now needed for maintenance purposes. We are in fact able to do more with less, with staffing levels now being reduced without service levels being jeopardised.¹⁸

15 Telstra, Submission 107b, p 2.

16 *ibid*, p 6.

17 Telstra, Submission 107c, p 4. Further information on Telstra's contract work force is provided in Committee Hansard, 7 August 2003, pp 956-957.

18 Mr Bill Scales, Group Managing Director, Telstra Country Wide, Queensland, Proof Committee Hansard, 6 August 2003, p 830.

5.15 Telstra took exception to the claims of witnesses, including union representatives, about the degraded and vulnerable condition of the telecommunications network:

...some witnesses have claimed that Telstra's network would collapse under the weight of heavy rain and sought to use the committee's Sydney hearing on May 10 to continue with this claim. However, it is fair to say that this claim has proven to be simply wrong. In May, despite some of the worst rains in Sydney in 40 years, the Telstra network did not collapse... I make this point simply to ask the committee to be as demanding on the claims of other witnesses as you are entitled to be on Telstra's.¹⁹

5.16 A Telstra witness pointed out that, in fact, MSDs are quite rare.

... less than one per cent of all CSG services were affected by CSG exemptions in the year 2002-2003. For the financial year 2002-2003 Telstra declared 65²⁰ CSG exemptions. There has been an increase in the number of exemptions, due to the smaller area of declaration. This actually goes to the heart of some of the questions that have been put to Telstra, in particular; if you make a declaration, how wide is that declaration? Telstra makes that declaration as small as possible with regard to the impact on customers and the impact on its productivity.²¹

Role of the Australian Communications Authority and the Telecommunications Industry Ombudsman

5.17 Representatives of the ACA explained that the organisation is constrained in assessing the need for an MSD declaration because any such assessment is essentially based upon information provided to it by Telstra. It agreed that Telstra can declare an MSD without recourse to anybody and that those adversely affected by such a declaration can seek redress only through the Telecommunications Industry Ombudsman or the courts, including through class action.²²

5.18 ACA Deputy Chair, Dr Bob Horton, would not venture an opinion on the acceptability of this situation, but commented:

19 Mr Bill Scales, Group Managing Director, Telstra Country Wide, Queensland, Proof Committee Hansard, 6 August 2003, p 831.

20 This figure was later revised by the witness to 66.

21 Mr Anthony Rix, Head, Service Advantage, Telstra, Proof Committee Hansard, 7 August 2003, p 949.

22 See Committee Hansard, 27 November 2002, pp 168-171 for further details.

I do not know if it is good enough or not. Certainly, from the strength of feedback that we are getting, there is a lot of concern about it.²³

5.19 The Telecommunications Industry Ombudsman, Mr John Pinnock, disputed the ACA interpretation of its role with respect to an MSD:

It is not true, in my view, though, to say that the Authority, if it had doubts about the applicability of an MSD in any given circumstance – in other words, its veracity – would not be able to look at the issue. I just do not agree with that.

...if the Authority is satisfied with that methodology [used in declaring an MSD] then even if I have some qualms from time to time, again the guarantee is its regulation. But if the authority is saying to the committee, ‘We do not have any powers to inquire into this,’ I just do not agree with that. It may not wish to or feel that there are grounds to do so, but the authority has very extensive powers under its Act.²⁴

5.20 The Committee’s attention was drawn to a review the ACA was conducting into MSD declarations:

...the ACA is currently conducting a review of information supplied by Telstra in the event of a MSD declaration. The review will consider the format and timing of information provided by Telstra to the ACA, the TIO and Telstra’s customers. It will also consider the creation of appropriate processes to ensure that MSD notices are only issued for areas that are affected by the cause of the outage or by the need to move staff or equipment from another associated area to attend the outage.²⁵

5.21 Mr Pinnock explained that he is advised only of the MSD notifications that are problematic.²⁶ While he had no particular concerns with the existing MSD declaration process he considered there was scope for greater scrutiny in overlooking it, especially on the part of the ACA, and that existing protocols essentially amounted to self regulation on the part of Telstra:

It is true that the authority has said, essentially, that this is a notification process, but it is more than a notification process because you are essentially allowing the carrier to self-declare an exemption under the guarantee. I

23 Dr Bob Horton, Deputy Chairman, Australian Communications Authority, Committee Hansard, 27 November 2002, p 170.

24 Mr John Pinnock. Ombudsman, Telecommunications Industry Ombudsman Scheme, Committee Hansard, 14 May 2003, p 691.

25 Mr Allan Major, Australian Communications Authority. Letter to Ms Jennie George MP. Included as an attachment to Submission 26.

26 Mr John Pinnock, Ombudsman, Telecommunications Industry Ombudsman Scheme, Committee Hansard, 28 March, 2003, p 267.

have always had a conceptual difficulty with that. I have always taken the view that there should be much greater rigour in looking at the basis on which you calculate the methodology... but that is not a matter I have control over. All I am left to do is look at individual complaints about whether an MSD properly applies to that customer service.²⁷

5.22 Mr Pinnock discussed the difficulty of defining extreme weather conditions in Australia as the basis for declaration of an MSD²⁸ but concluded that in fact Telstra's assessment of productivity is now the sole basis for declaration of an MSD. He considered this was an inherently problematic approach:

My concern. I guess, is that the methodology Telstra has used to underpin the MSD regime is wholly and solely based on productivity aspects. That means that the regime of notices can vary from time to time not only because of things such as staff leave commitments and these sorts of things but also because of decisions Telstra takes in a commercial sense as to what staff are going to be available as a whole....I am not saying that if it [Telstra] further reduces staff, the length of MSDs we will see in future will blow out. I do not think it is as unsophisticated a relationship as that. But I have never been entirely satisfied that this is the proper basis for assessing an MSD notice.²⁹

Review of the Customer Service Guarantee

5.23 In June 2004 the Government released its review of the USO and the CSG. Although the review mentioned that the issue of exemptions from the CSG had been raised in submissions it did not explore the issue in any detail³⁰. The review concluded that:

No further major changes to the CSG Standard are required at this time but it should continue to be monitored.³¹

Summary

5.24 The Committee acknowledges that the telecommunications carriers should not be liable for compensation payments for matters beyond their control and that some

27 Mr John Pinnock, Ombudsman, Telecommunications Industry Ombudsman Scheme, Committee Hansard, 28 March 2003, p 269.

28 See Committee Hansard, 28 March 2003, pp 699-700.

29 Mr John Pinnock, Ombudsman, Telecommunications Industry Ombudsman Scheme, Committee Hansard, 14 May 2003, p 698.

30 Department of Communications, Information Technology and the Arts, *Review of the Operation of the Universal Service Obligation and the Customer Service Guarantee*, p 209.

31 *ibid.*, p 221.

form of exemption from the provisions of the CSG is appropriate. The issue is whether the current MSD notification system is appropriate, or whether it simply represents a loophole in the CSG system that enables carriers to evade their responsibilities to their customers to provide adequate services.

5.25 This issue is one where the union and Telstra management have engaged in an argument of the 'glass half-full' nature. While the union has highlighted what it considers to be unacceptable behaviour by Telstra in relation to MSD declarations, Telstra has countered with its own, seemingly equally valid, interpretations. It will be a matter for the ACA review to resolve fact from fiction and to ensure that an appropriate system is developed.

5.26 Given the inconvenience and financial consequences for customers subject to MSDs, the Committee is particularly concerned at the apparent lack of independence in the MSD declaration process. It is this lack of independent oversight of the declaration process that gives the appearance of a loophole that is wide open for carrier exploitation.

Role and powers of the Australian Communications Authority

5.27 The Australian Communications Authority (ACA) has responsibility for a range of technical and service standards issues. It licenses telecommunications carriers, reports to the Minister on carrier performance, administers the USO, CSG and NRF regimes. However, its ability to effectively regulate the telecommunications sector has been brought into doubt during this inquiry.

5.28 The ACA has been established as very much a 'hands off' regulator, relying heavily on self-regulation and information monitoring rather than direct intervention. As such, it has not been particularly pro-active in ensuring that the Australian telecommunications network is capable of delivering adequate standards and levels of service to all Australians. The ACA monitors the compliance of carriers with the customer service guarantee and Telstra's performance under the Network Reliability Framework. However, the figures it produces through these processes are published well after the period to which they relate and measure the past performance of the network. They do not provide any information or guidance on the current state of the network, or on whether the network will continue to be able to meet acceptable standards of performance. Since the Besley report, the ACA has been required to report more regularly (i.e. monthly) under the Network Reliability Framework. This reporting has identified particularly poorly performing exchanges, with the ACA recently requiring Telstra to undertake remedial work in 54 rural exchanges.³² This has marked a change in emphasis in the role of the ACA, which the Committee welcomes and argues needs to be extended to improve network reliability.

32 Australian Communications Authority, *ACA identifies rural exchanges needing improvement*, Media Release No 30 – 15 August 2003.

5.29 A related issue is the limited range of monitoring undertaken by the ACA. The ACA's regular Performance Monitoring Bulletins are restricted in their focus to the provision of voice services. They do not examine the ability of the network to support adequate data services.

5.30 An issue of considerable concern is that the ACA's monitoring does not quickly show the true state of the Telstra network. In Chapter 2 of this report the Committee examined the available evidence on the level of faults in the Telstra network. The Committee received extensive evidence from the CEPU about the deterioration of the Telstra network as a result of falling capital expenditure and stop-gap repairs. As noted in that chapter the concerns of the CEPU were borne out by evidence from Telstra's own internal documents. However, at the same time that Telstra was recording sharply rising and record fault levels in its internal document, the ACA issued a Media Release saying that 'an analysis of faults occurring on Telstra's network between August and October 2003 showed an improvement in performance over the last quarter'.³³ The ACA's most recent Performance Monitoring Bulletin, published at the end of March 2004, does identify 'a progressive decline in the monthly percentage of Telstra fault-free services as measured by the Network Reliability Framework' but the ACA then goes on to state that 'declines in Telstra performance in the December and March quarters are typical of the seasonal patterns in the CSG figures'.³⁴

5.31 On 1 April 2004 the ACA announced a review of the Network Reliability Framework and called for public comment on the effectiveness of its operation.³⁵

5.32 Another weakness in the ACA's regulatory framework relates to the declaration of mass service disruptions by Telstra. As discussed earlier in this chapter the ACA has no independent role in gathering its own evidence about whether Telstra is justified in declaring a MSD. Nor has the ACA used these MSDs as triggers to investigate whether MSDs are indicative of underlying problems with the Telstra network.

5.33 The Committee is deeply concerned that the current light touch regulatory regime is failing to ensure that the Australian telecommunications network is being adequately maintained.

5.34 Another recurring issue in Telecommunications is the location of telecommunications infrastructure. At present neither the ACA, nor any other body, has comprehensive and publicly available maps setting out the location of existing and planned telecommunications infrastructure. This lack of information make it very

33 Australian Communications Authority, Media Release No. 64, 18 December 2003.

34 Australian Communications Authority, Media Release, 31 March 2004.

35 Australian Communications Authority, Media Release No 23, 1 April 2004.

difficult for state governments, local councils and regional organisations to understand what infrastructure is already available in a particular area and how that existing infrastructure can be used to improve access to services and increase competition. As most of the infrastructure is controlled by Telstra it enjoys a considerable competitive advantage through being the only party with a sound knowledge of the existing infrastructure.

5.35 A fundamental requirement in planning future telecommunications infrastructure is a knowledge of what infrastructure currently exists and where it is located. This is an issue which the regulatory regime should address.

Competition

5.36 For most of its history the Australian telecommunications industry has been a government monopoly, run by a single company and regulated by Commonwealth legislation. More recently, as outlined in Chapter 1, the industry has been opened up to competition.

5.37 While these changes have undermined Telstra's monopoly position in the telecommunications industry, it remains the dominant player, especially in the provision of infrastructure:

While there is a froth of competitive behaviour in the market place, the bulk of the profit in the industry is earned by one company. Telstra, the former monopoly incumbent is still the dominant player in many telecommunications markets.³⁶

After 10 years competition, Telstra earns 75% of the industry revenue, spends 67% of industry capex [capital expenditure], earns 95% of the industry profit, and has received \$625 million of the \$650 million spent by government on infrastructure projects. Over that time the industry has doubled in revenue to about \$30 billion.³⁷

Without effective infrastructure competition, services delivered are reliant on using existing facilities and technologies from incumbent infrastructure. The range of services available is limited to what the dominant provider chooses to supply. As the incumbent has control over access it has considerable control over prices.³⁸

5.38 While Telstra representatives did not dispute the dominance of the company's position, they considered that it has been overstated:

36 Australian Consumers' Association, Submission 71, p 3.

37 Australian Telecommunications Users Group Ltd (ATUG), Submission 89, p 11.

38 Optus, Submission 91, p 9.

The first myth is that Telstra is the Australian telecommunications network. Plainly and clearly, it is not. We believe Telstra's network represents approximately 70 per cent of telecommunications infrastructure and is now subject to vigorous facilities based competition in most sectors.³⁹

5.39 Mr Lawrence Paratz of Telstra Country Wide informed the Committee that there are 27 owners and carriers with physical infrastructure in Australia, 600 ISPs and more than 100 licensed carriers and mobile operators.⁴⁰

5.40 A number of witnesses suggested that Telstra uses its dominant position to engage in anti-competitive conduct, such as obstructing new entrants to the market and maintaining prices to consumers at unnecessarily high levels:

New entrants face considerable disadvantage and without strong competition regulation can be driven from the market. The existing telecommunications specific competition regulations have been beneficial in opening up Telstra's monopoly bottleneck facilities to facilitate new entry. However, Telstra continues to have significant control over facilities and key markets. More needs to be done to open up the playing field to promote real genuine competition.⁴¹

Even in the face of clear indications ... that policy makers are committed to increasing and strengthening competition, Telstra is seemingly intent on extending the market power it gains from its vertical integration. For example, Telstra has made it very clear to the market that, although it will allow other pay TV operators to use the Foxtel cable, it will not allow telecommunications competitors to offer Internet or high-speed data services via that cable infrastructure. In effect, it plans to lock up that communications gateway to the consumer and further suffocate the opportunity for competition in the market.⁴²

...it [is] the view of the ACA [Australian Consumers' Association] that the dominance of the market by Telstra, particularly in terms of revenue and profit, based on ownership of the vital core network, means that economically persuasive offers to consumers are hard to find.⁴³

5.41 It was suggested that Telstra's anti-competitive practices have had a particularly deleterious effect on consumers in rural and regional areas:

39 Mr Lawrence Paratz, Regional Managing Director, Southern Region, Telstra Country Wide, Telstra, Committee Hansard, 6 December 2002, p 286.

40 *ibid.*

41 Optus, Submission 91, pp 11-12.

42 Comindico Pty Ltd, Committee Hansard, 27 November 2002, p 142.

43 Australian Consumers' Association, Submission 71, p 4.

Outside those primary telecommunications markets in Australia, [Sydney and Melbourne] you do not have competitive infrastructure providers. The extreme case is the one with respect to the whole state of Tasmania where in fact there is only one provider of that underlying infrastructure. As a result, that has held back the deployment of separate connectivity and application services in those markets. That is, I think, the basic problem in most markets outside Sydney and Melbourne.⁴⁴

Telstra's pricing in the intercapital markets, where there is most competition, has reduced dramatically over the past few years and yet in regional areas, where they do not face the same level of competition, pricing is much higher.⁴⁵

5.42 It is claimed that the existence of such practices shows that moves since 1991 to open up the Australian telecommunications industry to competition have failed:

It is undeniable that competition in telecommunications has failed. Telstra controls most of the infrastructure and is a major shareholder in Foxtel which is seeking to merge with Optus at the services level. Because of its dominant market position, based on its ownership of infrastructure, Telstra is travelling quite well relative to telcos elsewhere in the world. Despite a very complex regulatory regime, Telstra's role as both network and service provider is at the heart of the problem. Telstra is totally focused on short-term, bottom-line performance in order to pay dividends to its shareholders (both public and private). Meeting the telecommunications needs of the public now and in the future is not its main focus.⁴⁶

5.43 The Australian Telecommunications Users Group summarised some of these failures as follows:

After five years of open competition in telecommunications, we now know:

A privatised incumbent operating in a competitive industry will always focus on maximising shareholder returns – forget promoting competition or end user interests.

The “light touch/industry self-regulation” approach has not been effective in protecting end users – and must be reversed.

...the “one size fits all focus” on infrastructure (facilities) competition rather than services competition has resulted in wasted capital and a negative reaction from the capital markets to further innovation.

44 Dr Terence Cutler, Comindico Pty Ltd, Committee Hansard, 27 November 2002, p 145.

45 Mr David Green, NTL Telecommunications Pty Ltd, Committee Hansard, 28 November 2002, p 253.

46 Ms Elizabeth Elenius, Submission 84, p 13.

The size and spread of the market have created difficulty in diffusing competition beyond the CBDs. Progress has only been achieved by direct Government funding.⁴⁷

5.44 Lack of information about existing infrastructure is argued to be a barrier to the development of competing infrastructure. Without ready access to information about what infrastructure exists, and where it is located, Telstra's potential competitors are at a significant disadvantage in planning the deployment of new infrastructure. During its inquiry the Committee found that little information about the location of existing infrastructure was available, although that situation improved somewhat as the inquiry proceeded. This issue will be discussed in more detail in the Committee's report on broadband competition.

5.45 Some commentators have suggested that Australia's population is too small and too scattered and Australia's terrain too difficult to support more than one successful telecommunications carrier, at least as regards the provision of infrastructure. This is the case for the country as a whole but is a particularly pertinent observation with respect to rural areas:

The reality of telecommunications infrastructure is that the access network (between the consumer and the local exchange) almost certainly constitutes a natural monopoly – particularly in outer metropolitan and rural areas.⁴⁸

5.46 A number of submissions went on to suggest that, since telecommunications infrastructure is a natural monopoly, it can most efficiently be provided by a single carrier under public control:

When considering the provision of services, such as telecommunications, in Australia, I believe that it is necessary to remember that we are in a unique situation. We have a very large landmass (comparatively, on a nation-wide basis), which is very sparsely populated over much of its area. Therefore, economic motivators such as profit will not induce private companies to invest in the interior of Australia, thus denying approximately 30% of Australians adequate services if they are not provided by the state.⁴⁹

It may be that in a country with a large landmass and relatively small and concentrated urban population, there is room for only one network, especially at the long haul and inter-exchange level, and especially to the residential consumer. If so, then that network should be considered a public infrastructure asset.⁵⁰

47 Australian Telecommunications Users Group Ltd, Submission 89, p 7.

48 Mr John Burke, RMIT University, Submission 69, p 5.

49 Ms Roslyn Joseph, Submission 32, pp 2-3.

50 Ms Elizabeth Elenius, Submission 84, p 3.

5.47 A further area of concern is Telstra's involvement in Foxtel. The Communications Expert Group submitted that:

... the power utility broadband networks are under serious threat if the Telstra/Foxtel/Optus monopoly can restrict or control the provision of content to other cable distribution services. While the power utilities can reduce installation costs, they will not be financially viable unless they can offer cable TV, broadband and telephone services to compete with Telstra's bundled customer services.⁵¹

5.48 Some witnesses suggested that the extent of Telstra's anti-competitive conduct is moderated by current levels of government regulation and oversight. With the full privatisation of Telstra this oversight will be greatly reduced and existing anti-competitive conduct can be expected to increase:

...Little competition exists outside the mobile and terrestrial markets and with the sale of the remaining portion of Telstra on the government agenda, any chance of preventing the core infrastructure falling into a monopolies control, is diminishing fast.

As Australians, we cannot let the full privatisation of Telstra [to] go ahead, without seriously considering the monopoly it will create in the wholesale market.⁵²

5.49 Various approaches were suggested to the Committee to avoid the emergence of a privatised, monopolistic Telstra exempt from any form of control. One suggestion was for the Government to buy back that portion of Telstra already in private ownership so that it can maintain its regulatory role and ensure that telecommunications developments meet national objectives:

The Government has to realise that if it sells Telstra, it will still have to provide continual support to Telstra countrywide and it has to run in a business approach (as it already does).

In this situation Telstra CountryWide is not a sale item but a main Government infrastructure provider. Likewise, Telstra Residential is not a sale item – as it makes no money. That leaves Telstra Business/Government – and its role is also therefore to support Telstra CountryWide with funds and expertise, such that the Government does not have to fund Telstra CountryWide!

It makes common economic sense for the Government to buy back at a reduced price the part of Telstra that was sold – and leave it an arms length Government business!⁵³

51 Communications Expert Group Pty Ltd and Community Tele-Services Australia Inc, Submission 86.

52 Mr Robert Ardill & Mr Grant Roper, Submission 8, p 4.

5.50 Another suggestion was that it should not proceed with the sale of the balance of Telstra. This, it was argued, would have a number of benefits including continued government oversight:

We oppose the sale of the 50.1 per cent balance of Telstra for a number of reasons. Firstly, there is the issue of ownership and the sale of public infrastructure to private interests, with a potential lack of control by the Australian government in ensuring service delivery, competitive pricing and high standards.⁵⁴

5.51 A further suggestion was that the Government should delay the sale of the remaining portion of Telstra until steps can be taken to ensure a more competitive environment is in place. During this transition period the Government could intensify its current efforts to enhance competition through support to new players. Some successful models were brought to the Committee's attention:

...the government needs to think very carefully about competition consequences of its policies and decisions as well as positive mechanisms that promote new players and new technologies. We are seeing significant steps in the right direction. I think the best example of this is the National Communications Fund, which came out of the Besley inquiry. It provided \$50 million for health and education communication services. It encouraged partnerships between carriers, state and territory governments and industry groups. It promoted large projects and operated in a way that was genuinely contestable.⁵⁵

That [the Coorong project, funded under the Networking the Nation program] is an instance where there has been a marriage between local government and private enterprise. They have successfully bypassed the Telstra network and have obtained significantly cheaper telephone calls within the district, the state and Australia. Calls cost a fraction of the normal rate. So that is an example of where federal government funding acted as a trigger. It got them over the hurdle, and they were able to establish the network. That is probably the most successful one that I know of, and it has been going for a number of years.⁵⁶

5.52 It was suggested that other models have been less successful and would need to be modified before wider implementation:

53 Mr Malcolm Moore, Submission 62, p 9.

54 Ms Vicki Brooke, Committee Hansard, 20 May 2003, p 783.

55 Mr David McCulloch, SingTel Optus, Committee Hansard, 6 December 2002, p 258.

56 Mr Douglas Kelso, National Office for the Information Economy, Committee Hansard, 27 November 2002, p 124.

...our view is that, if we are talking about national availability, we need to have a national program, or a policy framework at least, designed to do more than just encourage regional experiments – some of which may be successful for a time, some of which already have failed and some of which will probably be casualties of this current downturn. The problem with a lot of the funding so far, in our view, from Networking the Nation and such programs is that it has not been very well coordinated. It has not been part of a larger strategy.⁵⁷

In Optus' view, considerable opportunities to support new technologies, and new entrants into regional Australia have been wasted. In bolstering the incumbents' already dominant position, ongoing prospects to promote competition in regional Australia has been considerably undermined. But worse, some funding has actually promoted anti-competitive behaviour and destroyed competition in emerging markets.⁵⁸

5.53 A number of participants pointed to the need to minimise anti-competitive behaviour in a fully privatised Telstra through enhancements to the regulatory regime, which many considered is not particularly effective in its present form:

There is a clear need for tough regulation. The current powers of the ACCC and the TIO are far from adequate to control a fully privatised Telstra.⁵⁹

I believe that it is necessary to regulate to ensure that rural and regional Australians receive adequate telecommunications services now and in the future. This is particularly true if the telecommunications service providers are privately owned, as opposed to publicly owned, where there is (or should be) public accountability.⁶⁰

Competition policy and its application are key to achieving progress. Users want strong competition – to deliver choice of world class services at world class prices. ATUG feels focus is needed now on information based regulatory supervision in the face of decreasing opportunity for infrastructure and investment based competition.⁶¹

5.54 In recognition of the constraints on telecommunications operators in Australia and of the tendency to a natural monopoly in infrastructure, several witnesses suggested that one solution might be to retain the infrastructure in one company in public ownership while privatising the retail side of its operations:

57 Ms Rosalind Eason, Communications, Electrical and Plumbing Union, Committee Hansard, 26 November 2002, p 92.

58 Optus, Submission 91, p 13.

59 Mr Robert Ardill and Mr Grant Roper, Submission 8, p 5.

60 Ms Roslyn Joseph, Submission 32, p 2.

61 Australian Telecommunications Users Group, Submission 89, p 13.

In the opinion of the ACA [Australian Consumers' Association], what is needed is to split Telstra into separately owned portions, one of which has custody of the critical core network. This network is a natural monopoly, and should remain in government hands for the foreseeable future. However, we would not endorse a policy that might purport to stop the development of competitors to this network. Were competitive pressures to emerge to confront the government owned network, in our view these should be encouraged and the consequences played out....When the retail components of Telstra compete on equal terms for access to the core network with other companies, we might see real, sustainable competition deliver telecommunications benefits to Australian consumers. In our view, fully and finally privatising the vertically integrated and horizontally sprawling behemoth that is Telstra unreformed would not assist build genuine competitive pressures in the market, but would appreciably diminish the capacity for Government to bring the corporation to heel.⁶²

A combination of regulation and careful break-up of Telstra can offer Australia what it needs. Breaking Telstra down the middle into wholesale and retail components, where the retail arm of Telstra would become fully privatised and the wholesale arm remain fully government controlled. In effect, the wholesale arm would take on the form of a conventional public utility, where wholesale prices would be published publicly, allowing wholesale customers to compete on even terms.⁶³

We propose the formation of a cable network authority to design, manage and maintain Australia's line, terminal and cable infrastructure. Part of this infrastructure would have to be purchased from the privatised portion of Telstra. It would leave Telstra with its subscriber base, exchanges and ancillary services. The cable network authority concept means that ownership of the Australian cable network would be retained in public hands and subject to government control and regulation. It would help to solve the problem of parallel networks and the ownership issue. It would also foster true competition, free of the burden of cable ownership, by giving equitable access to all telcos, helping them to ensure quality of service delivery and competitive pricing for all Australians.⁶⁴

We are evolving a model very much like the roads network where on our roads we have all sorts of taxi companies, courier companies and transport companies competing and using whatever technology they want in order to compete. The only thing that makes it essential to compete is that they get

62 Australian Consumers' Association, Submission 71, p 40.

63 Mr Robert Ardill and Mr Grant Roper, Submission 8, p 5.

64 Ms Vicki Brooke, Committee Hansard, 20 May 2003, p 783.

free and fair access to the roads. That is the sort of model we believe perhaps needs examination in the context of telecommunications.⁶⁵

5.55 The case for structural separation was also supported by ACIL Tasman, with the support of the Competitive Carriers Coalition, in its submission to this Committee's inquiry into broadband competition. ACIL Tasman stated that the telecommunications sector is being curtailed by insufficient competition and that while Government reforms aimed at improving the competition regime were welcome, they are limited in scope. The submission referred to research in the US which suggests that agreements on access tend to be reached under vertical separation than vertical integration, that the incumbent was systematically more exploitative in negotiating under vertical integration; and that entry was systematically lower in regions served by the integrated incumbent.⁶⁶

5.56 ACIL Tasman also provided the Committee with a detailed study of the impact of structural change on shareholder value. This study found that economic theory does not predict an adverse effect for shareholders. The study went on to examine three cases of structural separation which showed that structural separation can enhance shareholder value.⁶⁷

5.57 Support for the possible benefits of structural change also comes from the OECD. In 2003 it issued a recommendation stating that:

When faced with a situation in which a regulated firm is or may in the future be operating simultaneously in a non-competitive activity and a potentially competitive complementary activity, Member countries should carefully balance the benefits and costs of structural measures against the benefits and costs of behavioural measures.

The benefits and costs to be balanced include the effects on competition, effects on the quality and cost of regulation, the transition costs of structural modifications and the economic and public benefits of vertical integration, based on the economic characteristics of the industry in the country under review.

The benefits and costs to be balanced should be those recognised by the relevant agency(ies) including the competition authority, based on principles defined by the Member country. This balancing should occur especially in the context of privatisation, liberalisation or regulatory reform.⁶⁸

65 Mr John Murphy, RMIT University, Committee Hansard, 26 November 2002, p 97.

66 ACIL Tasman, Submission 7, Inquiry into Competition in Broadband Services.

67 ACIL Tasman, Submission 7a, Inquiry into Competition in Broadband Services.

68 Organisation for Economic Co-operation and Development, *Recommendation of the Council Concerning Structural Separation in Regulated Industries*, 6 June 2003.

5.58 While many witnesses favoured the structural separation of Telstra into its wholesale and retail components, others noted that it was important to retain competition in wholesale as well as retail operations. Some pointed to the success of existing competition in infrastructure, with Reefnet in Queensland a prime example.⁶⁹ Others suggested that the price of reliance on a single carrier was greatly increased regulation:

So one of the consequences of going back to a single carrier is that you will need to introduce a whole lot more regulation to make sure you get the best possible outlook.

Fundamentally, I do not believe in single carrier solutions – but that again is reinforced by the fact that I think we do have the demand coming downstream that will support more than one carrier.

Another point with respect to a purely wholesale carrier is that you do not get vertical integration unless that wholesale carrier has a retail arm, and then there is the issue of how you regulate its relationship with its retail arm as opposed to its relationship with other retail competitors. So, again, you need regulatory apparatus to control that...I do not see that there is a compelling case to go to a single carrier.⁷⁰

5.59 Comindico suggested that the most effective means of enhancing the regulatory regime in telecommunications would be to extend the divestiture powers of the ACCC to include telecommunications, in situations of gross anticompetitive conduct:

We believe that only a fresh approach to the regulatory regime offers a hope of shifting Telstra's mindset and reinvigorating the market. We believe that can be achieved through the addition to the Trade Practices Act of the new 'last resort' remedy we speak about in our submission – the ability of the ACCC to apply to the Federal Court to order a company to divest itself of certain assets if it believes that a structural response is the only viable response to persistent anticompetitive behaviour.⁷¹

5.60 In March 2002 the then Minister for Communications, Information Technology and the Arts, the Hon Richard Alston, asked the Australian Competition and Consumer Commission to provide him with advice on the 'extent to which emerging market structures are likely to affect competition across the communications sector'. In response the ACCC provided the Minister with its report on *Emerging Market*

69 For details see The Hon Paul Lucas, Minister for Innovation and Information Economy, Queensland Government, Committee Hansard, 30 April 2003, p 534.

70 Mr Christopher Dalton, Committee Hansard, 19 May 2003, pp 720-721.

71 Mr David Forman, Comindico Pty Ltd, Committee Hansard, 27 November 2002, p 141.

Structures in the Communications Sector in June 2003.⁷² That report examined competition in telecommunications and found that:

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

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

- local, national, long-distance, international and mobile telephony
- dial-up and broadband Internet
- data
- printed and on-line directories
- pay TV (through its 50 per cent ownership interest in Foxtel).

Importantly, Telstra owns two of the three major local access networks outside the CBDs of major cities. In addition to owning the copper (PSTN) network that connects virtually every household in Australia, Telstra owns the largest cable (HFC) network, which passes 2.5 million homes. The second largest carrier in Australia, Optus, owns the other HFC network. This network passes approximately 2.2 million homes.

The extent of Telstra's dominance of the sector is demonstrated by the fact it receives almost 60 per cent of total industry revenue, which is almost four times the revenue that its closest rival, Optus, receives. It is reported to receive over 90 per cent of total industry profits.⁷³

5.61 The ACCC findings are broadly consistent with the evidence received by the Committee during its inquiry. The ACCC examined the possibility of enhancing competition by requiring Telstra to divest its HFC network:

For so long as Telstra owns or has an interest in a copper network and an HFC network, Telstra will be concerned about maximising the combined

72 Australian Competition and Consumer Commission, *Emerging Market Structures in the Communications Sector*, June 2003.

73 Australian Competition and Consumer Commission, *Emerging Market Structures in the Communications Sector*, June 2003, p xv.

revenues of both networks, and will therefore be hesitant to introduce new services or pricing on one network which cannibalises its revenues on the other.

Divestiture of the HFC network by Telstra would address this problem by introducing a new infrastructure competitor into the market against Optus and Telstra, establishing conditions for increased rivalry and innovation in the supply of a full range of telecommunications services. This competitor would have the potential to supply voice, broadband Internet and pay TV services directly to 2.5 million households passed by the HFC.

Increased competition would also provide better incentives for Telstra to invest actively in its copper network to provide for the delivery of a range of advanced broadband services. Overseas experience and independent analysis (including by the OECD) strongly suggest that the enhanced competition between independent networks should improve broadband price and service offerings and thereby increase the take-up of broadband services.⁷⁴

5.62 The ACCC recommended that the Government introduce legislation requiring Telstra to divest the HFC network in full and divest its 50% shareholding in Foxtel unless it can be shown that the costs of such divestiture outweigh the benefits.⁷⁵

Summary

5.63 Evidence to the Committee suggests that there is widespread unease at Telstra's continuing dominance of the Australian telecommunications network and the limited extent of competition in the provision of telecommunications infrastructure. While the reasons for this might be complex, as might be demonstrated by the lack of success of several major telecommunications infrastructure projects, the full privatisation of Telstra was nonetheless seen as potentially detrimental because it would be likely to give Telstra greater freedom to exploit its dominance of the Australian telecommunications network. The Committee notes that, through the Networking the Nation grants program, the Government has enabled some positive outcomes in rural and remote Australia, but only on a relatively small, localised basis. This is no substitute for a buoyant competitive marketplace where choice of delivery platforms will better meet consumer needs at competitive prices.

5.64 The evidence presented to the Committee strongly suggests that full privatisation of Telstra should not proceed until a more competitive market for telecommunication services is established. Given statements by Telstra CEO, Dr Ziggy Switkowski, at the Telstra AGM in August 2003 that he was unhappy with the company's slide to 65 per cent market share from its former 100 per cent monopoly, the Committee is

74 Australian Competition and Consumer Commission, *Emerging Market Structures in the Communications Sector*, June 2003, p xvi.

75 *ibid.*, p xxi.

concerned that Telstra may, in fact, engage in practices that will lessen what little competition already exists.

The role and powers of the Australian Competition and Consumer Commission

5.65 The 1997 reforms inserted into the Trade Practices Act 1974 specific provisions to deal with anti-competitive conduct in relation to telecommunications and to establish an access regime to give competitors access to key infrastructure and services. Responsibility for administering these competition provisions was vested with the Australian Competition and Consumer Commission (ACCC), Australia's national competition regulator. A brief outline of the ACCC's role is contained in Appendix 5.

5.66 The ACCC's recommendation that Telstra be required to divest its interests in its HFC network and Foxtel raises the issue of the adequacy of the ACCC's powers and its ability to foster competition in an industry which is already dominated by a single provider. The Senate Economics References Committee recently examined some of these issues and considered the issue of divestiture powers.⁷⁶ That report found that:

Australian trade practices law currently lacks the access to divestiture powers enjoyed by overseas jurisdictions; as a result, our competition authorities are limited in their ability to use divestiture either as a threat or as a remedy.⁷⁷

5.67 That Committee found that the existing divestiture power in section 81 of the *Trade Practices Act 1974* should be expanded so that divestiture becomes a remedy for other breaches of the Act.⁷⁸

5.68 The Committee is currently examining competition in broadband services in a concurrent inquiry. It will discuss the issue of the ACCC's powers as they relate to competition in the provision of particular services in its report on that inquiry.

76 Senate Economics References Committee, *The effectiveness of the Trade Practices Act 1974 in protecting small business*, March 2004.

77 *ibid.*, p 65.

78 *ibid.*, Recommendation 13, p 66.

