Submission for the

AUSTRALIAN SENATE ENQUIRY

Into the

AUSTRALIAN COMMUNICATIONS AND MEDIA AUTHORITY (ACMA)

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1. INTRODUCTION

Before examining the specific matters outlined in the Terms of Reference of the Inquiry, it is important to first look at the underlying issues. Why do we need regulations and what political frameworks are in place? Having established this, it becomes clearer what the role of ACMA should be, and whether it has sufficient powers vested in it to enable it to do the job.

As with most other infrastructure, telecommunications also behaves like a natural monopoly and therefore government policies are needed to regulate this monopoly. For a while it was thought that telecommunications could be more competitive and so should be treated differently from other infrastructure. This resulted in the government embarking upon its self-regulatory regime in the 1997 Telecommunications Act, which instituted a light-handed regulatory regime.

However, a declaration that telecommunications is 'competitive' does not ensure that any new market entrants can actually begin competing. Increasingly, governments around the world are realising that the value of their national telecoms assets is linked to the strength of their sector reform programs. Incumbents have successfully delayed competition and are regaining former monopolies. Competition, especially in infrastructure, is dwindling. At the time of the introduction of the 1997 Act the almost limitless nature of the power wielded by the incumbent telecoms operator was poorly understood and, as a result, the wrong policy decisions were made, based on light-handed regulations. It is now generally recognised that to introduce change around such a powerful incumbent required stronger regulatory powers.

New and innovative ways need to be explored to advance the cause of competition. Apart from increased regulatory powers, the structural separation of the incumbent is a key long-term policy that needs serious consideration. The infrastructure is separated from the rest of the retail organisation. While the infrastructure business (Netco) can still be (partly) government owned, the retails section (Servco) can be fully privatised. Mass penetration of broadband makes this concept also commercial viable.

In short, before detailed regulatory issues can be successfully addressed, the underlying government policies need to be revisited.

2. GOVERNMENT POLICIES NEED TO BE REVIEWED

2.1 REGULATIONS ARE BASED ON GOVERNMENT POLICIES

Until now government policies have focused on 'facilities-based' competition and 'open access or unbundling'.

Most of these policies have failed to deliver the outcomes envisaged by the government when they introduced the 1997 Act. There have been a few success stories in the long-haul market, but, even there, we have seen more information highway road-kill than successes.

Competition based on wholesale has proved to be a painstakingly slow process, as the incumbents have been extremely successful in delaying the course of progress, thus frustrating the industry, regulators and the government. Open access and unbundling, however, are still important alternative solutions for the last mile, and ongoing regulatory reform is needed to ensure that progress will be made.

It is obvious that facilities-based competition would have been the best solution for the current phase of competition in the brave new world of broadband-based telecoms. However, Australia lost this opportunity when the government allowed Telstra to compete head-on with Optus in the emerging cable TV market back in the early and mid-1990s. This mistake resulted in an even more powerful Telstra, which, unlike any other comparable telco, is allowed by its government to also operate a cable TV network.

The next level of infrastructure development is based on nextgen networks around fibre optics (fibre-to-the-home). However, alarm bells are ringing everywhere, as most incumbents are demanding regulatory relief from unbundling before they are prepared to build these networks, another clear indication that we are talking here about a natural monopoly.

Some politicians seem to mistakenly believe that wireless and Broadband over Powerlines (BPL), for example, can compete effectively with fibre as facilities-based competition in the last mile. Wireless and BPL are both niche market alternatives and will not get much more than 15% of the total infrastructure market – and then only in areas where fibre deployment is economically unviable (for example, in regional areas).

If fibre indeed is a natural monopoly, then governments need to recognise this and regulatory intervention is necessary, particularly in last-mile suburban areas.

All around the world it has been recognised that it is essential to find the best solution to address this 'structural separation'.

Exhibit 1 – Structural separation

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.

2.2 DIFFERENT REGULATORY MODELS – SAME OUTCOME

Around the word we see a trend back towards the monopolistic powers of the incumbent telcos.

For years we have been warning that the models structured around regulation will not deliver the outcomes that the governments of these countries envisaged. It is interesting to note that not one of the models has worked – no regulations in New Zealand; self-regulation in Australia; prescriptive regulation in the USA; and a range of intermediate formats in other parts of the world – none of them have been successful.

OFCOM in the UK is arguably the most successful regulator, as more sustainable changes have been made by it than by the regulators in any other country.

In every case the incumbents have proved to be far more powerful than all of the regulations combined. Their two major weapons in these battles have been their use of the legal system to challenge government regulations and their use of the political system to undermine the regulatory system. The outcome is the same – they remain completely in charge of telco developments.

2.3 MONOPOLIES TO REMAIN IN PLACE FOR THE NEXT DECADE

To a large extent the current regulatory battles are a lost cause – and therefore, also, the current regulatory environment. So any review of ACMA needs to take this into account. There is little or no sustainable competition, particularly on a facilities-based level. Mobile, perhaps, is the exception – however in mobile, also, there is a trend back to industry consolidation (for instance, the slide back from four 2G networks to two 3G networks), which will lead to market dominance and monopolistic behaviour.

On the all-important fixed network there is also a clear movement back to monopolies, especially in the USA, where the incumbents have been successful, both in their legal battles and in their political lobbying. The best that competitors can do in the USA is to make use of any crumbs that might fall off the table and/or to move into disruptive areas. However, the cable TV companies have become formidable facilities-based competitors to the telcos and now have a 50% market share in the broadband market.

Unlike companies in North America and Europe, new infrastructure companies in Australia did not receive enough government protection to enable them to become established. The most dramatic example here is the Optus HFC network. Street by street this network was overbuilt by Telstra, making it impossible for Optus to build it up into a successful operation.

At present, VoIP over DSL, based on unbundled local loop and line-sharing arrangements wrested, with the assistance of the regulators, from the incumbents, is one of the only possibilities for competition. However, in every case players are still dependent on the whims of the operators (resale, wholesale) and with one stroke of the incumbent's pen (pricewise) the business models of the competitors can be undone.

Disruptive technologies such as wireless broadband, VoIP, BPL, etc, are risky undertakings. They don't attract a lot of funding and are therefore doomed to remain niche markets.

So, it is safe to say that over the next five to ten years the incumbents will consolidate their position. Under political pressure some wholesale changes will be made, but overall it is hard to see that the incumbents will lose more than, let's say, 1% or 2 % market share per annum based on their total market (retail market share across all their products). With an expected market growth of 4%-5%, and perhaps a bit more towards the end of this decade, the incumbents will remain in front, and will continue to dominate, as they do today.

It is clear that, based on the current situation, government telecommunications policies need to be reviewed. Elsewhere, notably in the United Kingdom, governments have been, and still are, increasing the powers of the regulator in order to obtain the outcomes they have set for their telecommunications policies. Australia needs to take their lead and review its own policies.

3. ACMA ISSUES

3.1 CURRENT REGULATORY REGIME IS NOT FOCUSED

Because of the lack of a strong government policy vision the regulatory structure in our country is a hodgepodge. Just to summarise what we have at the moment:

- Australian Broadcasting Authority (ABA) – (to be merged with ACA):
- Australian Communications Authority (ACA) – (to be merged with ABA);
- Australian Competition and Consumer Commission (ACCC);
- Australian Communications Industry Forum (ACIF);
- Department of Communications, IT and the Arts;
- Telecommunications Industry Ombudsman (TIO).

And what we have feared all along is now happening – bureaucracies are exhibiting an enormous appetite for rules and regulations and are creating a labyrinth of paperwork. To date, decisive action, especially from the relatively toothless/ineffectual regulator, the ACCC, has been infrequent.

On top of this we have the political issues of privatisation, telecommunications in the bush, Senate Commissions and so on. All of these matters add to the delays already caused by the government's preferred option of self-regulation – which, of course, is seen as a godsend by the incumbent, fuelling its ability to delay progress towards increased competition.

3.2 SELF-REGULATORY REGIME ONLY WORKS FOR TECHNICAL ISSUES

Since the introduction of the Telecommunications Act 1997, and as a consequence of the market realities described above, telecommunication policies in Australia have consisted largely of a number of reactive, haphazard, stop-gap decisions, in an endeavour to overcome the many problems generated by the self regulatory regime.

This continues to be the case, because the underlying policy principles of the Act are flawed.

It was thought that a self regulatory regime would establish the level of competition envisaged by the government in the Act. And it certainly worked well in areas where there was little contention – basically on the engineering side of the industry, where technical issues are mostly resolved cooperatively. This, of course, is greatly assisted by the fact that the industry is blessed with a good set of international standards in respect of telecommunications technology.

3.3 SELF-REGULATORY REGIME DOESN'T WORK FOR COMMERCIAL AND POLITICAL ISSUES

However, problems occurred as soon as commercial and political issues were raised. For example, in the telecoms market, if competition is to work Telstra must lose market share, and it is obvious that no commercial organisation would ever voluntarily hand over market share to its competitors. Indeed, according to the Companies Act, it would be acting improperly if it were to do so.

Therefore it will use all its power to hang on to its monopolistic or semi-monopolistic markets for as long as possible in order to maximise returns to its shareholders. As a result, the government belatedly realised that the regulatory regime was not working as expected and began to create additional regulations on a continuous basis ever since. This has been a very bruising and disruptive development. Ongoing battles between the regulator and Telstra have been the main feature of the telecoms agenda the last eight years.

And in the process many telcos have gone under. Some of these companies were in the resale market, where wholesale margins have been kept as low as possible by Telstra; many of these operators were

too small to survive. But far more serious has been the fact that most facilities-based companies have gone under as well, and facilities-based competition is the only sustainable form of large-scale telecoms competition.

4. RECOMMENDATIONS

- Merge the technical divisions of the ABA with the ACA
- Leave the commercial and political media regulatory responsibilities within a separate ABA
- Establish a committee to investigate the establishment of a super regulator for media and communications, along the lines of the British OFCOM model

4.1 POLICY REVIEW IS NEEDED

Given the fact that the current telecoms policies have failed to deliver the outcomes the government envisaged, if the ACMA Inquiry is to be relevant a review of those policies is needed. Without a fresh set of government policies it will be impossible to make the ACMA work.

Regulators are simply the administrators of the government's policies, and in order for them to be effective their activities need to be based on sound government guidelines.

Considering what has happened elsewhere in the world it would be safe to conclude that in Australia, also, such a review would lead to more, rather than fewer, regulations and that it will call for a stronger, rather than a weaker, regulator.

Exhibit 2 – APEC calls for empowered regulators

The APEC Telecommunications Group is the working party of the APEC nations which deals with telecommunications and IT matters.

In late 2004, the group published a paper 'APECTel Effective Compliance Enforcement Principles' – an overview of the weapons that regulators need in their armouries. Drafted by senior officials from Australia, Canada, the Philippines, Singapore, Thailand and the United States it gives a sober, balanced overview focused on the concept of the 'Empowered Regulator'. As well as voluntary compliance mechanisms it concludes that a regulator needs to be able to impose a wide range of penalties when moral persuasion fails – including warnings, violation notices, orders to cease non-compliance, fines, seizure of assets, licence revocation and criminal proceedings.

4.2 STRUCTURAL SEPARATION IS ALREADY TAKING PLACE

The national infrastructure for the converged telecommunications, IT and media industries is, to a large extent, a natural monopoly. Let's acknowledge this and act accordingly by splitting the vertically-integrated incumbent in two – into an infrastructure-based organisation, partly owned by the government, and a fully privatised retail company operating in the free market.

Some steps have already been taken in this direction. Telstra has separated Sensis from the rest of its organisation and has also made the first move towards a further separation between wholesale and resale. In the mobile industry the two new 3G networks also follow the principles of a structurally-separated business model.

It is regrettable that the government is in denial about this. It should embrace the early growth of the industry and create policies that assist in further developments along these lines. In my opinion, it is also important to take these issues into account in the review, since this trend will have a tremendous effect on how the market should be regulated in the future.

At the same time it is also clear that, if the government doesn't follow the international trend and does not develop government policies that support the development of structural separation, it will take the risk of any future regulatory strategy continuing to be based on flawed policies and not delivering the outcomes it claims to be interested in.

This would produce an ongoing interventionist regime, which will not be good politically and will further undermine the development of telecommunications as an essential element in economic reform, economic growth and industry innovation.

4.3 SUPER REGULATOR IS THE ONLY WAY FORWARD

The need for a review of government policies becomes even more urgent as, so far, the government has not produced an overarching communications policy that takes into account both media and telecoms. The convergence of these industries demands that an overall regulatory regime be provided to manage these developments.

While many would argue for fewer regulations, so far no country in the world has been able to manage this – on the contrary, more regulations are the norm – the reason being that there are conflicting interests between the commercial operations of the companies involved and the national interest. Telecommunications is an essential infrastructure for any country's economy and social structure. Even in areas where telecoms is not a commercially viable proposition, telecoms services are needed and regulatory structures need to be in place to guarantee universal, ubiquitous and affordable services at roughly the same standard of quality around the country.

In the media sector it is essential that diversity and multiplicity are guaranteed and, again, monopolies in the form of media concentrations can be detrimental to the intellectual well-being of the nation.

Commercial interests would, of course, prefer fewer regulations, but the dominance of the companies involved in these markets makes regulations essential to protect the national interest.

Convergence makes it necessary to change the current regulatory regime, which is technology-based, into one overarching communication regime (taking the relevant telecoms, IT and media elements into account).

This is the first element of the 'super' regulator, and combined with that should be an increase of regulatory power as described above, adding a second 'super' element to the regulator.

4.4 ACMA IS A TOTALLY INAPPROPRIATE REGULATORY STRUCTURE

The merger of the ABA and the ACA misses out on most of the issues mentioned above and the creation of this new regulatory body without an underlying change in government policies is certainly not going to have any worthwhile effect on the overall situation. It may even make matters worse.

As already mentioned, it obviously does make a lot of sense to combine the technical regulations of the ACA and the ABA. This is an area where self-regulation works well.

However, only a relatively small part of the ABA – certainly not the major part of it – is related to technical issues.

Commercial regulations in respect of content, foreign ownership, media diversity etc are far more important matters, and they bear little relationship to the technical issues. The agendas are frequently set by politicians, and, given their current status, the regulators do not have enough power to withstand political pressure.

Media policies in Australia are mainly set through direct discussions between Messrs Murdoch and Packer and the Prime Minister.

Furthermore the technically oriented organisations, with their more introverted culture, are often intimidated and overwhelmed by the extroverted content and business sectors that govern the political

and commercial agendas. In the media, in particular, it is important to recognise the egos that are at play, which include the richest and most powerful people of the country.
The merged ACMA will be incapable of withstanding the pressure put upon it by these organisations and all its activities (including the technical regulations) could be severely negatively affected by this. ACMA is the wrong organisation to handle the commercial and political media issues.

The need for a split between technical and commercial (competition) issues was recognised in the 1996 telecoms reforms, when the competition issues were brought into the ACCC and the technical matters were handled by the ACA – a job, may I say, that the latter organisation has done tremendously well.

4.5 A POWERFUL REGULATOR NEEDED TO MANAGE A POWERFUL INDUSTRY

While the split between the ACCC and the ACA has not been a negative one for the telecoms industry, the plethora of regulators we now have, as listed above, is becoming increasingly difficult to maintain. The necessary focus is lacking, as well as, perhaps even more importantly, the necessary power to act decisively on the many contentious political and commercial issues the industry is facing. The trend around the globe is to bring the various regulatory authorities together under one umbrella. If it were vested with the appropriate powers, such a body would be able to regulate the rapidly converging industries.

Size does matter in this respect, as significant funds are needed to take on the very serious issues in this industry – an industry in which the stakes are so high that tens of millions of dollars can easily be spent during a single court case. Only a well-funded and powerful regulator will be able to operate effectively in this market.

4.6 WE NEED TO HAVE THE POLITICAL WILL TO MAKE CHANGES

The key to the success of this review is, again, the political will to bring about the required changes.

A powerful regulator – one that is a match for the very powerful media and communications interests – should be put in place to oversee the total regulatory landscape. Within this super regulator there would be divisions for the various segments.

And it is universally agreed that the technical regulations could safely be moved to the edge of the organisation, as self-regulation is the way of the future there.

On the other hand, all the national interest elements should be kept together and managed as a whole. These include national infrastructure strategies, media diversity, foreign ownership, competition regulations, consumer issues and so on.

4.7 ESTABLISH A COMMITTEE TO INVESTIGATE A SUPER REGULATOR

While the solution is pretty straightforward, we should look at the best elements of super regulators elsewhere and combine these to form a structure that is relevant to the Australian environment.

Does Australia have the political will to do so?

To test this, my suggestion would be to set up a Commission that looks at doing precisely that. Investigate the best regulatory practices from around the world and provide sound advice on the regulatory framework needed for Australia. I have provided the Secretariat of the Senate Environment, Communications, Information Technology and the Arts Committee with contacts in the UK and the USA that could assist in this process.

As a matter of urgency, however, the political and commercial media responsibilities will have to be left out of ACMA. These should, for the time being, remain within a separate ABA, until a more strategic regulatory plan has been developed.

Paul Budde

Bucketty Australia,
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