Chapter 6

A blueprint for the future

> I have always said that one thing the government missed was a blueprint for telecommunications in Australia. Where is the vision? What do we want to do? Where does structural separation fit? Where does the monopoly fit? Where can we have competition? Unless we map the whole thing and say what is needed, we will be having Senate inquiries like this for the next five or 10 years. That is what will happen unless somebody says, 'This is the blueprint and this is the grand plan of action that we have to put in place.' The government never took the initiative; Telstra never took the initiative. Unless we do such a thing we will always have contradictory elements.[1]

6.1 In this report the Committee has highlighted a wide range of matters within the current telecommunications regulatory regime which impede competition and investment and do not adequately protect consumers. Most glaring is the lack of a long-term strategic vision for telecommunications throughout Australia. The Committee concurs with the comments made by the Hon John Anderson MP, then Deputy Prime Minister:

> I have said several times over the past months that the real telecommunications debate should be about securing the services that regional Australia needs, not about selling a phone company. Today in Australia we have what is essentially a 19th century telephone system trying to serve a 21st century information economy. What we should be doing is looking ahead. … Our responsibility, though, is to the national interest and the interests of regional Australia - and we will only serve their interests if we can create a 21st telecommunications system for Australia.[2]

6.2 The Government's intention to privatise Telstra fully as soon as possible appears to have diminished its will to develop this long-term strategic view. Ms Rosalind Eason from the CEPU argued there was 'a kind of policy vacuum' in telecommunications:

> … as far as the long view goes, the impending privatisation has brought all of these strange ideas out of the woodwork, and some are stranger than others. It is muddying the waters. It is very hard to have a policy debate now about what sort of regulatory framework we might need in the next 10 years without it being overlaid by the whole privatisation question. On the one hand is the notion that the government is rejecting all ideas simply because it wants to enhance the share price…On the other hand are various interests, more or less opportunistic depending upon where they come from,

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1 Mr Paul Budde, *Committee Hansard*, 13 April 2005, p. 58.

2 The Hon. John Anderson MP, Deputy Prime Minster, Speech at the NSW Liberal Conference, 17 June 2005, accessed 29 June 2005: http://www.ministers.dotars.gov.au/ja/speeches/2005/AS11_2005.htm.

> who see this as the moment—the kind of 'we have only three months to get it right otherwise this country is doomed' sort of argument—to gain policy leverage. The whole thing seems to us a very unfortunate conjuncture. That is why we have argued that the privatisation matter should be put aside for the time being. Let us look at the regulatory framework, let us look at new generation networks, the changes happening and what is needed to roll out a modern communications suite of services in Australia, then let us perhaps come back to that matter 10 years down the track.[3]

6.3 As outlined in chapter 2, a dominant theme which emerged during the inquiry was that insufficient progress has been made in providing adequate telecommunications services to rural and regional Australia. Further, there is broad community concern that the situation will worsen once Telstra is fully privatised.

6.4 The Committee notes the Government's commitment to the Telstra sale being conditional on adequate telecommunication service levels in rural and regional Australia,[4] and urges the Government to honour this pledge, including by holding off on passing the necessary legislation until the condition is met. Accordingly, the Committee has kept the desired outcome of improved rural and regional telecommunications services at the forefront during the development of its recommendations.

6.5 The Committee was encouraged by the Minister's recent announcement that a licence condition was soon to be placed on Telstra compelling it to maintain a focus on rural services:

> I expect to be imposing a Licence Condition on Telstra by the end of the month … This is not negotiable – T3 or no T3 – Telstra will be required to maintain their level of service to the bush. … Telstra will be working over the coming weeks to present me with a workable and responsive rural presence plan.[5]

6.6 The Committee notes that the Government announced on 4 August 2005 that such a licence condition had been imposed.[6] Telstra is required to develop a local presence plan which will be open for public comment for at least six weeks and is

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3 Ms Rosalind Eason, *Committee Hansard*, 20 June 2005, p. 20.

4 This commitment was recently reiterated by Senator the Hon Helen Coonan, Minister for Communications, Information Technology and the Arts, who stated that adequate services to rural and regional Australia is one of three 'preconditions' for the stage-three sale of Telstra. 'Address to the Adelaide Press Club', 7 July 2005, p. 2, accessed 8 July 2005: http://www.minister.dcita.gov.au/media/speeches/address_to_the_adelaide_press_club_-_12.30pm_thursday_7_july-_check_against_delivery_-_7_july_2005_adelaide

5 Senator the Hon Helen Coonan, Minister for Communications, Information Technology and the Arts, 'Address to the Adelaide Press Club', 7 July 2005, p. 8.

6 Senator the Hon Helen Coonan, Minister for Communications, Information Technology and the Arts, 'Telstra's rural, regional and remote presence to be assured', *Media release* 91/05, 4 August 2005.

subject to the Minister's approval.[7] However, the Committee emphasises that the value of such measures will depend almost entirely on their final content.

6.7 This chapter summarises the findings of this inquiry and proposes a number of initiatives in response in the following areas:

- the structure of Telstra;
- the ACCC;
- the TPA: Part XIB and section 46;
- the TPA: Part XIC;
- meeting consumer demands;
- the USO; and
- other consumer protection issues

The structure of Telstra: achieving greater transparency

6.8 In Chapter 3, the Committee discussed Part XIB of the TPA, which is the regulatory mechanism aimed at addressing anti-competitive behaviour in the telecommunications sector. A number of weaknesses in the mechanism were identified. Central to the problem are Telstra's capacity to mask the delineation between its wholesale and retail costs and the limitations on the ACCC's ability to establish anti-competitive conduct.

6.9 The Committee has heard evidence which suggests that the lack of transparency between Telstra's wholesale and retail costs is a significant impediment to the effectiveness of the TPA.[8] Further, attempts to address this issue, such as the introduction in 2002 of the enhanced accounting separation regime (discussed in Chapter 3), have not given the ACCC a satisfactory means of determining whether Telstra operates so as to give its retail arm an advantage over its wholesale customers. As Optus submitted:

> There is ongoing debate concerning the separation of Telstra. At the heart of this debate is the concern that Telstra will continue to have strong incentives to favour its own retail operations at the expense of competitors who are wholesale customers. These incentives are very difficult to detect or curtail. Optus is well aware of, and experiences on a daily basis, Telstra's behaviour in this respect.
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> The accounting separation regime that was introduced in 2002 required greater disclosure by Telstra of its costings and internal pricing. This was

7 The Minister has issued written guidance to Telstra: see 'Local Presence Plan Guidance', August 2005, accessed on 8 August 2005 at http://www.dcita.gov.au/tel/regional,_rural_and_remote_communications/local_presence.

8 ACCC, *Submission* 17, p. 5.

> designed to make it easier for both the ACCC and Telstra's competitors to determine if Telstra was favouring its own retail operations.
>
> The result has been disappointing, a fact recognised by both the industry and the ACCC. The information being provided is far too disaggregated to be used in any meaningful way, and the ACCC has indicated that there is little potential for improvement.[9]

6.10 In response to this lack of transparency and Telstra's monopoly over the network, a number of models have been suggested which aim to provide a clearer indication of Telstra's internal wholesale price to its retail business. As Mr Ian Slattery from Primus told the Committee:

> The arguments behind structural reform and structural rearrangements of Telstra are at the heart of the issue as to what is currently stifling competition, and they are Telstra's monopoly or control over key network elements which display monopoly characteristics which competitors rely on as an upstream input to provide competitive retail services. The fact is that Telstra is dominant in just about every market segment of telecommunications. They are the drivers behind why structural arrangements within Telstra need to be considered.[10]

6.11 The models most frequently proposed in response to lack of transparency are structural separation and operational separation. These models are reviewed below.

Structural separation

6.12 One proposed remedy is the structural separation of Telstra into two separate organisations, that is, wholesale and retail. The Australian Consumers' Association supported this approach:

> … because if the normal logic of wholesale competition were allowed to operate, access would become less of a foreground issue.[11]

6.13 Mr David Spence from Unwired Australia told the Committee that structural separation would stimulate competition and innovation.[12]

6.14 An article by Professor Peter Gerrand[13] examined the arguments for and against structural separation of Telstra, and in particular the buyback of the 'natural monopoly' of Telstra's fixed network into public sector ownership. Professor Gerrand noted that the benefits of a buy-back were offset by the prospect of two major electoral liabilities: the anger of minority Telstra shareholders if they lost shareholder

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9 Optus, *Submission* 12, pp 16-17.

10 Mr Ian Slattery, *Committee Hansard*, 11 April 2005, p. 17.

11 Australian Consumers' Association, *Submission* 16, p. 6.

12 Mr David Spence, Unwired Australia, *Committee Hansard*, 13 April 2005, p. 112.

13 Professor Peter Gerrand, 'Revisiting the Structural Separation of Telstra', in *Telecommunications Journal of Australia*, Vol 54 No 3 Spring 2004, pp 15-28.

value and the excessive demands on the federal budget in the year of the buy-back. Professor Gerrand supported a hybrid solution, a two-stage process, whereby both the costs and risks to the government could be significantly minimised.

6.15 However, arguments against structural separation of Telstra are based upon claims of cost and complexity, akin to 'unscrambling an omelette'.[14] Telstra argued that structural separation would be costly and would result in a loss of efficiency:

> It has become apparent that structural separation in telecommunications imposes large costs in terms of efficiency and international competitiveness. Structural separation results in a loss of the efficiencies that are achieved through vertical integration. As a result, customers are forced to bear higher costs. In addition, it is not clear that there are significant benefits from separation, especially not of the order required to outweigh the substantial costs involved.[15]

6.16 However, the true cost and complexity of the task of structurally separating Telstra are unknown. The ACCC Chairman, Mr Graeme Samuel, told the Committee:

> I think it is fair to say that there has been some work—but not an extensive amount of work—done into the cost and benefits associated with structural separation. The process that has been discussed by the ACCC in previous submissions—and I think you referred to a document signed off by me which would have involved a previous role that I had with the National Competition Council—has indicated that it may have been beneficial to examine the costs and benefits associated with structural separation. I am not aware that such a detailed examination of those costs and benefits has been undertaken.[16]

6.17 The Productivity Commission concluded in its recent report on National Competition Policy Reform:

> In such a rapidly changing environment, were full vertical structural separation to be pursued, it could be very difficult to determine precisely where the split should be made. Consequently, the scope for regulatory error, and its attendant costs, would be high.[17]

6.18 Mr Bill Scales from Telstra told the Committee that 'some constructs of structural separation' would now be 'technically impossible to do':

> What is often not taken into account in this structural separation debate is that Telstra is a much more complex beast than it was five, 10 or 15 years ago. At that time—and I am overstating it here—it was a relatively straightforward copper network. Now we have copper; fibre; a layer on top

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14 Australian Consumers' Association, *Submission* 16, p. 6.

15 Telstra, *Submission* 25, p. 30.

16 Mr Graeme Samuel, *Committee Hansard,* 9 May 2005, p. 3.

17 Productivity Commission, *Review of National Competition Policy Reform,* No. 33, 2005, p. 241.

> of that, which is IT systems; and a layer on top of that, IP systems. They are completely integrated, so the question becomes: how do you make an appropriate separation of that, without virtually having Telstra as it currently is? … To be quite frank, I have not seen anybody who has done any of the work to be able to make the appropriate judgements about the costs and benefits.[18]

6.19 Mr Stephen Dalby from iiNet argued that in any case, structural separation would not provide adequate transparency:

> Structural separation between retail and wholesale does not solve the problem for me when I am dealing simply with Wholesale. I might never deal with Retail, although their behaviour may still affect me. I am trying to strike a deal where I am moving from high-margin wholesale products to low-margin wholesale products and negotiating with somebody that does not want that to happen. I wonder really whether that is another layer of separation that is required between these sorts of full function wholesale products versus the bare bones building blocks.[19]

6.20 The Committee was also told that attempts to modify the structure of the industry by legislation was unlikely to be more productive than allowing regulatory and market processes to run their course:

> It is yet to be demonstrated that legislated structural changes in other industries in Australia have produced superior long-term results than could have been achieved by other less disruptive means. … In telecommunications such separation would be likely to result in inappropriate as well as inadequate investment in infrastructure; that is assuming that the 'infrastructure' could actually be identified separately from services equipment and after it was done, that the purpose or use of the infrastructure would be known.[20]

6.21 Mr Bill Scales from Telstra criticised the ACCC's support for structural separation, arguing that accounting separation, the mechanism currently employed to produce internal transparency between Telstra's wholesale and retail businesses, had not been fully implemented and given an opportunity to work:

> We have not even fully implemented accounting separation, and yet people in the ACCC are saying it does not work. So the question for an organisation like Telstra when it goes before the board is: what do we say about that? Because, on the face of it, it looks as though we have a regulator that has decided that it wants to have structural separation of the company; and to ensure that it puts itself in the best position to argue the policy case for structural separation it will undermine.[21]

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18 Mr Bill Scales, *Committee Hansard,* 4 May 2005, p. 81.

19 Mr Stephen Dalby, *Committee Hansard*, 29 April 2005, p. 41.

20 Mr Doug Coates, *Submission* 2, p. 2.

21 Mr Bill Scales, *Committee Hansard*, 4 May 2005, p. 71.

6.22 As both ATUG[22] and Optus[23] noted, the Government has made it clear that it has no intention of considering structural separation of Telstra.[24] Mr Peter Lindsay MP told the Committee he opposed any form of forced separation of Telstra, which should be allowed as a private company 'to make its own decisions about what it does and how it runs its business'.[25] However, some industry analysts believe that Telstra will eventually structurally separate of its own accord. Mr Paul Budde told the Committee:

> I am absolutely against forced structural separation. It is the wrong way to go. It is politically totally impossible, so let us not even argue about it, because that would be a waste of time. Structural separation will automatically happen. Telstra is going to structurally separate itself—there is no doubt in my mind about that—within the next five years. So let us assist it to actually find the right sorts of models that will push it in a particular direction rather than forcing it upon it when nobody wants it.[26]

6.23 Mr Budde argued that Telstra had already begun internally separating:

> You would be surprised how far Telstra have already moved themselves in that direction. They will not tell you, but they have. There is a very good wholesale division. The people in wholesale would be laughing and jumping up and down if we did do structural separation. These are all good people who want to look after their wholesale business. They all want to do the best thing for their wholesale customers. So they would love to be passionate about wholesale and sell the right to the services to their customers. … If you simply separate the wholesale division in that situation then the rest will automatically follow because then the wholesale division will get a much better focus and the retail division will get a much better focus.[27]

6.24 Optus noted that during the 1980s, the US government imposed a break up on the dominant company, AT&T. The company was split into a long distance company and seven local telephony companies, each under separate ownership.[28] The

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22 ATUG, *Submission* 20C, p. 4, where it stated: '… the Australian Government has repeatedly refused to seriously contemplate the structural solution. The Government's shareholding in Telstra is an explicit conflict of interest in developing policy options for the telecommunications sector and its consumers.'

23 Optus, *Submission* 12, pp. 16-17. Accordingly 'Optus sees little point in making the case for such a reform'.

24 See also Senator the Hon Nick Minchin, Minister for Finance and Administration, *Senate Hansard,* 21 June 2005, p. 24; Senator the Hon Helen Coonan, Minister for Communications, Information Technology and the Arts, 'Address to the Adelaide Press Club', 7 July 2005.

25 Mr Peter Lindsay, *Committee Hansard*, 21 April 2005, p. 6.

26 Mr Paul Budde, *Committee Hansard,* 13 April 2004, p. 46.

27 Mr Paul Budde, *Committee Hansard*, 13 April 2005, p. 53.

28 Optus, *Submission* 12, pp 16-17.

Committee sought evidence on comparable arrangements in other Australian market sectors such as energy. Mr Paul Broad from PowerTel stated:

> It is worth recognising that, in the energy sector, once a private sector company got involved, for example in Victoria, they immediately separated their network business from their retail business. When owned by governments, the big conglomerates were the way to go. They subsidised their retail businesses through their regulated businesses. They hid all their back-office costs in the regulated businesses so that their retail businesses could be competitive. They destroyed value. Once they were sold, the private sector recognised that the market will rate the retail businesses differently from the network businesses. … The market will adapt. Once the market signals are clear through the industry structure, then in my view we are more likely to attract foreign investment compared to what we have today, which is uncertainty about what structures are likely to emerge.[29]

6.25 The Productivity Commission argued that the transaction cost to full structural separation would be large and therefore:

> … such transaction cost considerations now tip the balance against the full vertical separation of Telstra, regardless of the intrinsic merits of a separated structure in a 'greenfields' situation. However, given the continuing concerns about Telstra's capacity to discriminate against its retail competitors in the provision of network services, greater operational separation is worth further consideration. … Though the potential benefits would be smaller than those on offer from full vertical separation, so too would be the attendant efficiency and transaction costs.[30]

6.26 Some witnesses such as Mr Charles Britton from the Australian Consumers' Association pointed out that the need to engage in a debate about restructuring Telstra remains:

> We would accept some of the arguments about the fact that the Telstra omelette is scrambled, if you like, and you cannot separate it out et cetera. We would not have any sympathy for the notion that therefore we should not move on to a debate about operational separation. … It is certainly timely to talk about operational separation because the time to talk about structural separation may have passed but the problem that structural separation would address has not passed. It is an ongoing reality that we have got a vertically integrated, horizontally sprawling incumbent sitting in the middle of the market.[31]

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29 Mr Paul Broad, *Committee Hansard*, 11 April 2005, pp 18-19.

30 Productivity Commission, *Review of National Competition Policy Reform, No. 33,* February 2005, p. 242.

31 Mr Charles Britton, *Committee Hansard*, 13 April 2005, p. 65.

Operational separation

6.27 In light of the Government's rejection of structural separation, an operational separation model is gaining momentum. As Mr Samuel from the ACCC stated:

> Operational separation is a concept that seems to be finding favour with a number of significant stakeholders in the debate over the future of Telstra – these include Government and Opposition spokesmen, Telstra's competitors and it seems, from media reports, possibly even elements of Telstra itself. The ACCC is strongly supportive of the concept of operational separation. [32]

6.28 Noting that there had been some confusion about what was meant by operational separation, Mr Samuel clarified the difference in the following way:

> The essential difference between the two is that of ownership. Both types of separation involve establishing some parts of Telstra as separate business entities. Under structural separation these separate business entities would be sold to new owners and would no longer be part of Telstra. Under operational separation these separate business entities remain as part of Telstra.[33]

6.29 Witnesses and submissions supported the concept as a pragmatic alternative. Mr Ewan Brown from SETEL told the Committee:

> We have now developed a policy of operational separation because we believe that it is feasible in the current mind-set and the current marketplace environment. Given the limited extent of the powers of the ACCC, we feel that there is an element of goodwill, and an element of pressure might be able to bring that to bear and achieve that transparency of operation between the wholesale and retail sectors which would really allow the provisions of the Trade Practices Act to work properly in this marketplace.[34]

6.30 However, Mr John Feil, Executive Director of the National Competition Council, noted that operational separation was a 'trade-off':

> … between the scope and complexity of regulation required to moderate Telstra's market power and the structure of the business. Structural separation is likely to address both the ability and incentives for anticompetitive behaviour, whereas lower order separation is likely to reduce the ability to engage in anticompetitive behaviour principally by making such action more apparent, along with the attendant regulatory consequences. But it will have limited effects on the underlying incentive to

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32 Mr Graeme Samuel, Chairman, ACCC, Speech at National Press Club, Canberra, 27 April 2005, p. 3.

33 Mr Graeme Samuel, Chairman, ACCC, Speech at National Press Club, Canberra, 27 April 2005, p. 3.

34 Mr Ewan Brown, *Committee Hansard*, 11 April 2005, p. 52.

> utilise market power. It is possible that structural separation would allow for less regulation especially of those parts of the business that exhibit natural monopoly characteristics and can be effectively separated from commercial activities.[35]

6.31 Similarly, Mr David Forman from the CCC stated:

> We regard operational separation as a mechanism by which you seek to emulate as far as possible the outcomes that you would see in a structurally separate Telstra with the recognition that without full structural separation you can never get to the core incentive on Telstra that has been identified in the past by the ACCC to discriminate against access seekers who are its competitors at a retail level.[36]

What operational separation would require

6.32 Mr Samuel told the Committee:

> … an ACCC enforced operational separation would enable us to achieve the objective that I outlined in my opening statement, which is to be able to promote effective competition in the telecommunications sector.[37]

6.33 The ACCC outlined its proposal for operational separation in the following terms in its submission to the Productivity Commission's review of National Competition Policy:

> Under this arrangement, each business would have its own management, location and information systems, and operate as an independent profit centre with specific objectives. The wholesale business would be expected to treat both its internal retail counterpart and external third party retailers at arm's length and on a non-discriminatory basis. Legal or corporate separation is a potential variation where the entities take the form of legally separated firms.[38]

6.34 During this inquiry, the ACCC submitted that operational separation would need to be underpinned by formalised arrangements, including requirements that the two businesses:

- deal with each other on a commercial arms-length basis, including transparent pricing arrangements between Telstra's wholesale and retail arms as well as separate invoicing and billing;
- maintain fully separate accounts and reporting systems, capable of capturing all transactions between the businesses; and

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35 Mr John Feil, *Committee Hansard*, 4 May 2005, p. 91.

36 Mr David Forman, *Committee Hansard*, 11 April 2005, p. 15.

37 Mr Graeme Samuel, *Committee Hansard*, 9 May 2005, p. 14.

38 Cited in CEPU, *Submission* 40, pp 22-23.

- maintain separate staff at all levels, with staff remuneration tied exclusively to the performance of the relevant separated business.[39]

6.35 The Australian Consumers' Association supported 'effective' operational separation, which would require 'ring-fencing' of Telstra's retail and wholesale activities:

> This should be more than just a strengthening of the accounting separation framework and is more than the mere development of a separate wholesale division within Telstra. It is necessary to effectively ring-fence Telstra network operations from retail activities. This would create an internal separation between a 'retail business' supplying services to consumers, and a 'network business' supplying network or wholesale services to both Telstra retail and retail competitors. Such ring-fencing would have the following characteristics:
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> - Maintenance of separate legal entities for internal business units;
> - Allocation of costs in a reasonable manner;
> - Transparent pricing arrangements between wholesale and retail arms;
> - Separate invoicing and billing systems;
> - Fully separate accounts and reporting systems;
> - Limitations on common staff and sharing confidential customer information; and
> - Staff incentives linked exclusively to the relevant business unit.[40]

6.36 Optus argued that an effective operational separation model would need to include:

> - The establishment of Telstra's access division as a separate operational entity. Under this measure, Telstra Retail would acquire the same services as access seekers. A transfer price would be clear and visible, and Telstra Retail and Telstra Wholesale could be required to prepare accounts based on retail prices.
> - The establishment of requirements for price and non-price non-discrimination by Telstra Wholesale, i.e. a clear non-discrimination rule. Enforcement action to address breaches of the non-discrimination requirements could be obtained in the absence of proof that the breach has resulted in a substantial lessening of competition.
> - The creation of monitoring and reporting requirements for the regulator on measures of discrimination. Such monitoring could focus on, for example, the access prices that Telstra charges its retail division compared with those charged to its competitors, and the

39 ACCC, *Submission* 17, p. 6.

40 Australian Consumers' Association, *Submission* 16, p. 6.

> Service Level Agreements (SLAs) applicable to Telstra Retail compared to those of its competitors.[41]

6.37 The Committee heard that some of Telstra's competitors supported operational separation if it delivered a level of transparency that would address Telstra's current discriminatory practices against its wholesale customers. Mr David Forman from the CCC told the Committee:

> We have argued that operational separation needs to deliver transparency, but that transparency is there not as a means of itself—that is accounting separation. It needs to deliver the ability for the regulator to look for acts of discrimination. … The other elements of the regime such as separate boards, separate staff—and, we would argue, separate locations for a number of operations, if that is not one of those issues—go to behaviour and to the ability to discriminate. It is not simply about prices; it is about discrimination that manifests itself in other ways. We have discussed it in various documents: information asymmetry, information leakage, the issues of Telstra's ability to see into some of the arrangements that appear to be conducted between a competitor and Telstra Wholesale and for some of that information to apparently find its way into Telstra's retail business.[42]

6.38 ATUG submitted that accounting separation was 'ineffective and not likely to work, as it is based only on notional data and does not reflect actual prices/transactions between Telstra Wholesale and Telstra Retail'.[43] ATUG argued that operational separation was needed and that certain requirements must be met:

> One of the outcomes of any move to Operational Separation must be explicitly agreed contracts between Telstra wholesale and Retail which can be mirrored with competitors to ensure equivalent access (price and non-price) is being provided and to ensure that the behavioural and incentive changes that are needed in Telstra for competition to be effective can occur. A critical part of implementation of operational separation will be the introduction of information systems to provide a high degree of confidence that equivalent access is being delivered.[44]

The UK experience

6.39 Optus highlighted the United Kingdom's (UK) approach in relation to its market incumbent, BT. UK regulator OFCOM released a *Strategic Review Telecommunications Phase 2 Consultation Document* in November 2004 which argued that equivalence of access must be tackled 'head-on'. Equivalence of access refers to the same or similar regulated wholesale products, at the same price and using

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41 Optus, *Submission* 12, pp 23-24.

42 Mr David Forman, *Committee Hansard*, 11 April 2005, p. 21.

43 ATUG, *Submission* 20a, p. 3.

44 ATUG, *Submission* 20a, p. 3.

the same or similar processes. In OFCOM's view, creating equivalence requires both organisational and behavioural change:

> • "Significant shift in [the incumbent's] behaviour at an organisational level in support of equivalence at the product level
>
> • "Changes in management structures, incentives and business processes, which today remain as a consequence of [the incumbent's] historic structure as a vertically-integrated operator
>
> • "Information flows within [the incumbent] which mirror the information flows between [the incumbent] and its wholesale customers, so that its customers are able to influence [the incumbent] to the same extent that different parts of [the incumbent] can influence each other
>
> • "That this level of equivalence within the organisation can be demonstrated through transparency" (p15).[45]

6.40 OFCOM had noted that one option for consideration in relation to BT was reference of the matter for investigation by the Competition Commission under the *Enterprise Act 2002* (UK), a possible outcome being the structural separation of BT. In February 2005, BT offered some voluntary changes to its business and organisational structure and OFCOM has worked with them and other industry participants since that time.[46]

6.41 On 20 June 2005, OFCOM published details of its new approach to regulation of the UK's fixed line telecommunications market.[47] BT had offered legally binding undertakings[48] in lieu of a reference under the *Enterprise Act 2002* (UK) to the Competition Commission and these were accepted by the OFCOM Board, subject to final consultation.[49]

6.42 BT's undertakings include the following:

- An operationally separate business unit will be established, provisionally entitled Access Services, to be staffed by about 30,000 BT employees currently responsible for BT's local access networks. The unit will have separate physical locations for management teams, separate employee bonus schemes, separate operating and trading systems and, in time, new branding which emphasises its operational separation.

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45 Optus, *Submission* 12, p. 18.

46 OFCOM 'Strategic Review Telecommunications Phase 2 consultation document: telecommunications statement', 23 June 2005, accessed on 27 June 2005 at http://www.OFCOM.org.uk/consult/condocs/telecoms_p2/statement/.

47 OFCOM, 'A new regulatory approach for fixed telecommunications', 23 June 2005, accessed on 27 June 2005 at http://www.ofcom.org.uk/media/news/2005/06/nr_20050623.

48 In the event of a breach, OFCOM may take the matter to the High Court. Third parties affected by the breach may also seek damages.

49 The consultation period of 6 weeks commenced on 30 June 2005.

- The new unit will be required through formal rules on governance and separation to support all providers' retail activities on a precisely equivalent basis called 'Equivalence of Input'. This means that all providers will benefit from the same products, prices and processes, to ensure that they can order, install, maintain and migrate connections on equal terms.
- The new unit will offer a universally available product and service set, comprising Local Loop Unbundling products, all forms of wholesale line rental and backhaul products. Equivalence of Input will also apply to BT's wholesale internet products used by many ISPs to provide broadband connections.
- There will be 'a number of clear principles' which BT should follow in the design, procurement and guild of its next generation 21st Century Network, in order to help ensure other providers who rely on the network do not suffer competitive disadvantage.
- A new Equality of Access Board will monitor compliance with the undertakings (but will not be an operating management board).[50]

6.43 OFCOM's Chief Executive Stephen Carter was quoted as saying:

> The OFCOM Board proposed to accept BT Group plc's proposed undertakings on the critical assumption that BT Group plc does not merely deliver the letter of the undertakings, but also the spirit.[51]

Regulatory models in other sectors

6.44 As noted earlier, the Committee sought further information about regulatory models in other market sectors during this inquiry. In the Australian energy sector, models exist for 'ring-fencing' the monopoly and competitive activities of utility companies.

6.45 Both the National Gas Code and mandatory guidelines issued by the ACCC under the National Electricity Code contain ring-fencing provisions that have been operating for some time. Under these provisions, utilities are required to maintain separate legal entities for their internal business units. These arrangements do not preclude the separate businesses from being owned by the same shareholders, but they improve transparency and address underlying incentives to engage in discriminatory behaviour.[52] Mr Paul Broad from PowerTel Ltd told the Committee:

> In all the energy businesses I know around the world, separation from network and retail has occurred in some form or other. With regard to the

50 OFCOM, 'A new regulatory approach for fixed telecommunications', accessed on 27 June 2005 at http://www.ofcom.org.uk/media/news/2005/06/nr_20050623.

51 OFCOM, 'A new regulatory approach for fixed telecommunications', accessed on 27 June 2005 at http://www.ofcom.org.uk/media/news/2005/06/nr_20050623.

52 ACCC, *Submission* 17, p. 5.

> model that the ACCC are referring to, businesses in fact did most of that. The ACCC encouraged it and threatened it. Of course, they had the power to do it and made us all sit up and take notice. When we did do it, it was the best thing for our businesses, because we could actually see where we were making money, particularly in some of the old network businesses that had retail attached to them and found the retail businesses were losing lots of money.
>
> To me, it is in Telstra's best interests, in the market's best interests and in the interests of those who are competing. It goes to the heart of: transparency and openness stops all these dead weight losses and the costs involved in running inquiries and having regulators all over you. Surely, from their perspective, they would want to be in the driving seat rather than be driven to an outcome they are not comfortable with.[53]

6.46 In Melbourne, the Committee heard from Mr Paul Fearon, Chief Executive Officer with the Essential Services Commission, who outlined ring-fencing arrangements in the electricity and gas sectors:

> The ring fencing for electricity and, for that matter, for gas—and we are talking here principally about distribution and retailing—has not been the issue that it has been with telecommunications. It comes back to the fact that the contestable activities in energy and the natural monopoly network elements are much more separable…
>
> Nevertheless, we have put in place ring-fencing arrangements…The ring fencing is essentially the financial or accounting separation, with what I would call a relatively benign form of operational separation. That basically comes down to separation of staff, access of information and some limits on joint marketing. The reality is that there is not a strong internal driver to keep these two businesses together anyway. In fact, those businesses that have maintained both of those businesses have recognised that the value to their business is maximised by having them fairly separate in terms of the skills, attitudes and cultures that are required to run them both.[54]

6.47 The success of ring-fencing or operational separation models in the energy sector was compared with the failure of the model applied to telecommunications. As Mr Broad bluntly stated:

> The energy industry did the reform and did it right. In fact the states that did the energy reform—and I have just spent seven years running an energy company—did it right. The feds that did the telco one got it wrong.[55]

6.48 The effectiveness of the energy sector's approach to privatisation and separation was also highlighted by Mr Paul Fearon from the Essential Services Commission:

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53 Mr Paul Broad, *Committee Hansard,* 11 April 2005, pp 21–22.

54 Mr Paul Fearon, *Committee Hansard*, 4 May 2005, p. 43.

55 Mr Paul Broad, *Committee Hansard,* 11 April 2005, p. 18.

> In Victoria, the businesses were legally separated but sold in a stapled form. Since then, there have been a number of transactions which have essentially unstapled them. But there is no regulatory or legislative barrier to these companies being jointly owned. Basically, they were physically dealt with before they were privatised. So the old gas and fuel sectors in Victoria created three staple distributor retailers, and they were effectively operationally and physically separated prior to privatisation.[56]

Concern about operational separation

6.49 Some submissions argued that operational separation was a knee-jerk reaction which had not been considered in concert with wider policy and strategic plans for the telecommunications industry. The CEPU argued:

> There is no consideration, for instance, of what further policy provisions might be required for such separation, once established, to be maintained. Would Telstra wholesale be permanently debarred from offering retail products? Would Telstra retail be denied the right to invest in new infrastructure (e.g. spectrum)? And what would be the effect of imposing what amount to line-of-business restrictions on Telstra, but not on any other vertically integrated operators?
>
> What are the implications of the model for the pricing of "wholesale" products which regulation currently requires be offered on a retail-minus basis i.e. local calls? Would Telstra wholesale be allowed to charge for these services at prices that allow the recovery of traffic sensitive costs i.e. on a timed basis? If so, what happens to the untimed (retail) local call obligation?
>
> What impacts would "virtual separation" have on residual cross-subsidies such as those involved in the geographic averaging of line rental prices? What are the implications for the funding of universal service?
>
> No discussion of "operational separation" which the CEPU has seen to date offers answers to these questions.[57]

6.50 Similarly Optus, while supporting 'an examination of further changes within Telstra to assist in delivering equivalency', cautioned that operational separation, like accounting separation, could require significant cost and effort for no net gain:

> In assessing the imposition of any new regulatory requirement, it is necessary to assess the benefits to be achieved against the cost in implementing the requirement. … While operational separation options may have a theoretical attraction, there is a considerable danger is that the same barrier will be encountered; namely, Telstra will resist change and the regulator will be unable to gain sufficient insight to force organisational and

56 Mr Paul Fearon, *Committee Hansard*, 4 May 2005, p. 45.

57 CEPU, *Submission* 40, p. 24.

> behavioural requirements to deliver tangible outcomes. The end result could be significant effort and cost for no net gain.[58]

6.51 AAPT argued:

> Any such development needs to be carefully designed to ensure that the separation is not merely illusory, as the consequence could be the introduction of additional cost without matching benefit.[59]

6.52 Similarly ATUG submitted:

> Record keeping rules such as Accounting Separation are ineffective, and Operational Separation is a concept untried anywhere in the world as yet and with significant problems even at concept stage. For example, under Australia Corporations Law ATUG is not sure whether an access services division, within Telstra, could ever be sufficiently independent of Telstra's overriding corporate responsibilities to grow and run the wholesale business effectively. It may be that we require separate company structures at a minimum for Operational Separation to be effective.[60]

6.53 Associate Professor Ian Atkinson argued that operational separation looks very similar to structural separation and may well be more complex and difficult to manage:

> I am essentially a scientist. I like to apply the principles of Occam's razor. If it looks like a cat, smells like a cat and moves like a cat, then it is a cat. Within the Australian context, do we really have enough people in business with enough skills to actually run a ring fencing operation like that? I just think it would inevitably fail.[61]

6.54 Similarly Mr Bill Scales from Telstra argued:

> This does look to me like structural separation. It has all the elements of structural separation. It has all the elements that the ACCC called structural separation less than 12 months ago. I am inclined to think that if it looks like a duck, walks like a duck and quacks like a duck then it is a duck. This to me is structural separation under another name.[62]

6.55 However, representatives from the ACCC refuted Mr Scales' claims succinctly:

> Mr Willett—Mr Scales is quite wrong on that, quite ill-informed. It is not structural separation.

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58 Optus, *Submission* 12, p. 18.

59 AAPT, *Submission* 13, p. 8.

60 ATUG, *Submission* 20C, p. 10.

61 Associate Professor Ian Atkinson, *Committee Hansard*, 21 April 2005, p. 50.

62 Mr Bill Scales, *Committee Hansard*, 4 May 2005, p. 78.

Mr Samuel—If it is a duck, then it has no beak.[63]

Application of models to other competitors

6.56 Not surprisingly, Telstra's largest competitor argued that organisational reform legislation should be directed solely at Telstra:

> Optus is concerned to ensure that any structural separation measures are strictly targeted to where the harm exists, namely Telstra and its fixed line network. Any legislative requirements should impact only on Telstra and, to that end, the requirements should be placed in the Telstra Act, not in the Trade Practices Act.[64]

6.57 However, the Committee notes that many of Telstra's competitors also have the potential to grow to a powerful market position. Some submissions stressed that Telstra was not the only large, vertically integrated telecommunications company in Australia. As Mr Bill Scales from Telstra stated:

> The dynamic nature of the telecommunications market and the emergence of new technologies have further intensified the competitive pressure on Telstra…[T]here are now over 150 licensed carriers in the market competing with Telstra. Many of these competitors are vertically integrated and they are also horizontally integrated. There are many affiliates of powerful foreign owned and even foreign government owned corporate multinationals. Some of them with whom we are competing today are actually larger than Telstra. These affiliates can draw on the extensive resources of those multinational entities when competing in the Australian market, and they do.[65]

6.58 Any legislation which would alter the structure of Telstra must also be applicable to its competitors, who may find themselves the beneficiary of regulatory intervention and consequently in a dominant market position. As the CEPU argued:

> … any proposal to structurally separate Telstra must be viewed in the context of industry structure as a whole. … Splitting Telstra into two separate companies, while leaving (say) Singtel Optus to enjoy all the advantages of vertical integration has never seemed to the CEPU to represent a coherent policy option.[66]

The Committee's view

6.59 The Committee believes that greater transparency between Telstra's wholesale and retail businesses is clearly needed. While the Committee has heard many calls for operational separation and notes that there is growing support for this model, the

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63 Mr Ed Willett and Mr Graeme Samuel, ACCC, *Committee Hansard*, 9 May 2005, p. 8.

64 Optus, *Submission* 12, p.19.

65 Mr Bill Scales, *Committee Hansard*, 4 May 2005, p. 56.

66 CEPU, *Submission* 40, p. 21.

Committee is not entirely persuaded that operational separation will provide the level of transparency required by the regulator and by Telstra's wholesale customers.

6.60 The Committee recognises that true transparency may only be delivered by structurally separating Telstra. This model will remove the incentive for Telstra to favour its own businesses over its competitors. It will encourage innovation and investment in infrastructure, as Telstra wholesale will benefit from providing services to as many customers as possible. The Committee agrees with Mr Paul Broad who argued:

> The culture of running a network business, where your objective is to minimise capital and to load it up, is vastly different from the culture of running a wholesale business, which is vastly different from the culture of running a retail business. To use one to subsidise and not really know what that subsidy is, to me, is not a sustainable long-term management practice for running businesses.[67]

6.61 The Committee has previously recommended that the Productivity Commission should be asked to undertake a full examination of all the options for structural reform in telecommunications, including the structural separation of Telstra.[68] The Committee notes that the Productivity Commission in its report in February this year concluded that full structural separation 'would inevitably be expensive and time consuming' and that transaction cost considerations 'now tip the balance' against full vertical separation, pointing to some overseas experience.[69] However, the Committee is concerned that there has still not been a detailed review of this option with proper financial analysis, and for that reason repeats its previous recommendation that there should be a full independent review.

Recommendation 1

6.62 The Committee recommends that the Productivity Commission be asked to undertake a full examination of structural separation of Telstra.

6.63 Despite the persuasive arguments for structural separation, the Government has indicated that it is unwilling to explore this option.

6.64 Operational separation appears to have gained support from different segments of the telecommunications market as a second best option. The Committee heard substantial evidence on the features that such an operational separation model might include.

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67 Mr Paul Broad, PowerTel Ltd, *Committee Hansard,* 11 April 2005, p. 21.

68 Senate Environment, Communications, Information Technology and the Arts References Committee, *Competition in broadband services*, 2004, Recommendation 3.

69 Productivity Commission, *Review of National Competition Policy Reforms*, Report No. 33, February 2005, pp 241-243.

6.65 The Committee heard that the aim of an effective operational separation regime should be to replicate as far as possible the incentives and transparency of structural separation, whilst attempting to avoid some of the costs of implementation. Based on this evidence, the Committee has formed the view that if operational separation is pursued, the model for this separation should, at a minimum, include the features of the ACCC's proposed model. Any model of operational separation that fails to incorporate these threshold requirements is likely to have limited prospects for success.

Recommendation 2

6.66 The Committee recommends that if the Government decides to pursue operational separation of Telstra over structural separation, it should adopt as a minimum the framework and operating rules outlined by the ACCC in its proposed model.

The ACCC

> We also understand the principle of walking softly and carrying a big stick. Those regulators who have a big stick can afford to walk softly, whereas those without may have to trot nervously through the jungle.[70]

6.67 The Committee heard much criticism of the ACCC's ability to deal appropriately with competition and access issues in telecommunications. Criticising the ACCC's handling of the 2004 competition notice process, some submissions queried whether it was a matter of a lack of will on the part of the regulator or inadequate powers. Mr Paul Budde articulated this concern:

> How is it possible that, given the apparently 'blatant' anti-competitive behaviour that has been occurring in the broadband market, the regulator failed to act promptly and decisively. Other issues, such as mobile termination rates, Internet peering and unbundled local loop, demonstrate that the ACCC appears regrettably ineffective.
>
> …This leads me to conclude that either:
>
> - the ACCC's current powers are insufficient to act or
> - the ACCC is not using effectively the powers it had.
>
> The fact that no decisive action is taken plus the fact that the regulator has clearly indicated that Telstra is 'too large to regulate', caused me to conclude that the ACCC indeed is an inadequately empowered regulator.[71]

6.68 Many acknowledged the ACCC's difficult task in regulating a sector so heavily dominated by one vertically integrated company, and argued that the regulator should be given further information-gathering powers. The Western Australian Department of Industry and Resources (WADIR) submitted:

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70 Mr Richard Thwaites, ATUG, *Committee Hansard*, 11 April 2005, p. 39.

71 Mr Paul Budde, *Submission* 1, p. 6.

> The regulators have been assigned a difficult task and need comprehensive and relevant information in order to make the best possible decisions. Toward this objective, the Commonwealth Government should provide all regulators with unfettered and mandatory rights to compel information from telecommunications providers. In the interest of promoting fair and open competition, substantially more information relating to the telecommunications network should be disclosed publicly.[72]

Penalties

6.69 The ACCC's ability to impose adequate penalties to deter anti-competitive behaviour was also raised. As discussed in Chapter 3, some witnesses felt that financial penalties were insufficient. As Mr Damian Kay stated:

> It is corporate bullying. That is a broad, sweeping term, but how do you stop it? The rules are there now to say [Telstra] cannot do that. They have to provide the same service to the end customer, no matter who that line is billed through. So the rules are there. If someone comes down hard on Telstra out of this and says: 'You can't do this. We have all these examples and we are going to fine you $20 million,' they would have made more than $20 million out of this.[73]

6.70 Dr Walter Green argued that corporations and businesses that were caught engaging in anti-competitive conduct should be 'automatically' fined:

> The biggest concern, and one that has been used not only by Telstra but by a couple of others to destroy the competition, is the offering of a retail price which is below the wholesale price. To me it should be in the legislation that if you are caught doing that it is automatic that you will get fined. Just improving that will change the whole dynamics as to how pricing is done. In fact we have been asked to look into two current areas where what Telstra is offering to the large corporate customers is below the wholesale rate that is being offered to carriers.[74]

6.71 ATUG also submitted that to encourage fast compliance an immediate fine should be levied on anti-competitive behaviour:

> The monetary incentive should be used to encourage fast compliance given the safeguards that are in place PRIOR to a notice being issued. The fine should be applied immediately and return of same could be the subject of negotiation on proof that anti-competitive conduct has ceased. Part XIB is not designed to support the negotiation of access prices. That is the role of Part XIC. Part XIB is designed to penalize anti-competitive conduct.[75]

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72 WADIR, *Submission* 32, p. 1.

73 Mr Damian Kay, Telcoinabox, *Committee Hansard*, 21 April 2005, p. 24.

74 Dr Walter Green, Communications Experts Group, *Committee Hansard*, 29 April 2005, p. 18.

75 ATUG, *Submission* 20C, p. 3.

6.72 The Committee notes that suggestions that the ACCC rather than a court have power to impose immediate penalties for certain conduct would present constitutional difficulties arising from the separation of judicial and executive powers, and for that reason does not support these suggestions. However, the Committee considers that the sentiments expressed demonstrate the level of concern about the effectiveness of the current regime.

Other powers

> I do not know that you necessarily need an army in the ACCC, but they need to have the tools. There were some comments made about predetermining what the pricing environment ought to be. That might be a solution and that may avoid the need for building up more muscle within the organisation. Take the competition notice over the ADSL: I was involved as a witness in that process and for 12 months I was giving witness statements. There were a lot of resources spent.[76]

6.73 Optus argued that there was a need for further regulatory reforms, including giving the ACCC additional tools so that it can move more quickly to block Telstra's anti-competitive behaviour. Optus' specific proposals included:

> A prohibition on Telstra unreasonably discriminating in favour of its own retail operations through the introduction of a non-discrimination rule. This would require Telstra to demonstrate it is not discriminating in the way it treats its competitors and itself where it resells services. This would overcome the significant hurdle of competitors currently having to prove Telstra is discriminating when it behaves anti-competitively.
>
> Measures that prevent Telstra targeting customers it has lost to competitors for 180 days (such measures are in place today in Canada). This would remove Telstra's ability to use its competitive advantage to undermine competitor's efforts to acquire customers.[77]

Cease and desist

6.74 The Australian Consumers' Association suggested that the ACCC should be given 'cease and desist' powers when seeking to resolve apparent anti-competitive behaviour. This power, the Association argued, 'would increase incentives to resolve competition issues, while improving the sensitivity of the system to market entrants'.[78]

6.75 Mr David Havyatt from AAPT argued that 'cease and desist' powers would have been beneficial if they had been available during the 2004 ADSL competition notice episode:

> … the issue with the price squeeze we saw was that Telstra had dropped a retail price and then not adequately reduced its wholesale price. A cease and

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76 Mr Stephen Dalby, iiNet, *Committee Hansard*, 29 April 2005, p. 41.

77 Optus, *Submission* 12, pp 4-5.

78 Australian Consumers' Association, *Submission* 16, p. 4.

> desist order would have allowed the ACCC, rather than go through a long process of having the wholesale prices negotiated, to say to Telstra, 'You cannot drop that retail price until you have satisfactorily dealt with the wholesale price.' Both of those would have had beneficial outcomes in terms of the administration of the regime.[79]

6.76 Further, AAPT submitted:

> … Telstra continued to offer anti-competitive prices after the issue of the notice. The problem would be avoided if the ACCC had the power to issue "cease and desist orders" in conjunction with a competition notice.[80]

6.77 Similarly, Unwired Australia argued that the ACCC needed cease and desist powers 'as well as or in place of its competition notice powers':

> Only then will actions cease and irreparable damage to the market that can occur during an investigation be avoided.[81]

6.78 However, the Committee notes that a 'cease and desist' power raises a possible constitutional issue arising from the relationship between judicial and executive powers.[82] The 2003 *Review of the Competition Provisions of the Trade Practices Act*[83] (the Dawson Report) did not support a proposed amendment to Part IV to confer a 'cease and desist' power on the ACCC, noting:

> There is a real question whether the proposed amendment would involve the ACCC in the exercise of judicial power and hence be invalid. The power to make binding orders (albeit temporary) based on a determination by the ACCC that there was a breach of the Act, even though the orders would be enforceable only by the Court, would appear to involve the exercise of judicial power.[84]

6.79 The Dawson Report stated that those difficulties had not been resolved. In any case, such an amendment was not supported because of the availability of injunctions under the TPA and the lack of evidence to show that a 'cease and desist' process would be speedier than obtaining an interim injunction.[85] The Committee notes that

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79 Mr David Havyatt, *Committee Hansard*, 11 April 2005, p. 31.

80 AAPT, *Submission* 13, p. 6.

81 Unwired Australia, *Submission* 48, p. 3.

82 Dr Mitchell Landrigan, Telstra, *Committee Hansard*, 4 May 2005, p. 57.

83 Trade Practices Act Review Committee, *Review of the Competition Provisions of the Trade Practices Act*, 2003, (Chairman Sir Daryl Dawson).

84 Trade Practices Act Review Committee, *Review of the Competition Provisions of the Trade Practices Act*, 2003, (Chairman Sir Daryl Dawson), Chapter 5.

85 Trade Practices Act Review Committee, *Review of the Competition Provisions of the Trade Practices Act*, 2003, (Chairman Sir Daryl Dawson), Chapter 5.

injunctions are also available for contraventions of the competition rule and other rules in Part XIB.[86]

6.80 Dr Mitchell Landrigan from Telstra also noted:

> I would point out that as part of the Dawson recommendations there is going to be quite significant bolstering of the penalty provisions in part IV. I would have thought that for those who are concerned about the administration of part IV that would be quite a welcome thing.[87]

6.81 The Committee also heard evidence which suggested that granting the ACCC 'cease and desist' powers may not deter anti-competitive behaviour because of Telstra's extensive legal resources. Mr Charles Britton from the Australian Consumers' Association stated:

> The cease-and-desist type power is possibly tainted. You have the competition notice regime. In theory, that allows them to step in…If cease-and-desist had the same unhappy outcome as the competition notice, then that is what I am saying about a reluctance to get more shovels out for that hole. It does dig us deeper in. Telstra has potentially got more lawyers than the ACCC, so in that sense the ACCC is not going to win that arm wrestle for us.[88]

6.82 The Committee believes that if the ACCC had had 'cease and desist' power in the 2004 ADSL competition notice matter, the process may have been resolved in a more timely manner. However, the Committee also notes the views on possible constitutional difficulties with the grant of this power and the availability of injunctions. Accordingly the Committee does not recommend 'cease and desist' powers for the ACCC at this stage.

Divestiture powers

6.83 The Committee heard from such groups as the Communications Experts Group[89] and the CCC which argued that the ACCC should be given divestiture powers, that is, the power to compel structural separation in response to anti-competitive behaviour, as part of its array of regulatory powers.

6.84 Mr David Forman from the CCC stated:

> We have consistently argued that that is a screamingly obvious element that is missing from the regime at the moment. At the moment, the ACCC has extensive competition notice powers that go to fines, but nothing beyond that. We are talking about a $4½ billion company. It would have to be a pretty substantial fine to mean anything, to be material…At the moment, I

86 Section 151CA.

87 Dr Mitchell Landrigan, *Committee Hansard*, 4 May 2005, p. 57.

88 Mr Charles Britton, *Committee Hansard*, 13 April 2005, p. 63.

89 Communications Experts Group, *Submission* 26, p. 4.

> cannot see that fines of the magnitude that is likely to be contemplated under any breach of the act would be a sufficient disincentive to make Telstra walk away from something that it considers fundamental to retaining its market power. If, however, it had to consider the fact that the regulator may attempt to actually change the structure of the company, then that could be a real disincentive.[90]

6.85 Mr Paul Budde expressed similar views:

> Facing the reality of a powerful government that is unwilling to properly address the issue of structural separation, the ACCC should at least be provided with the authority to use this threat as a weapon to force Telstra to change its anti-competitive behaviour and its regulatory game-playing.[91]

6.86 However, not all submissions supported this proposal. It was claimed that despite the antitrust court decision in the United States some twenty years ago, in which the Bell System was broken up, the industry has now reformed on lines not dissimilar from the original structure.[92] Yet it was argued that in the intervening period much time has been wasted on bureaucratic regulation, some innovation has been retarded and there was extensive overinvestment in transmission capacity.[93] Dr Mitchell Landrigan from Telstra noted that there had not been a detailed debate of divestiture powers:

> Divestiture is clearly a complicated issue and much of the debate has not been about strict divestiture of entities as they currently exist but about incremental power that has effectively resulted as an accretion of creeping acquisitions. To my knowledge there has not been detailed debate about divestiture per se of an entity in its existing form.[94]

6.87 Despite these concerns, the Committee has heard a substantial amount of evidence which suggests that the current penalties available to the ACCC to achieve enforcement of XIB and XIC are inadequate. The Committee believes that the financial penalties do not act as a sufficient deterrent to anti-competitive behaviour and that other deterrents are needed.

6.88 When Mr Samuel was asked whether the ACCC sought divestiture powers, he stated that the ultimate aim was to bring about more transparent arrangements between Telstra's wholesale and retail operations so as to allow the ACCC to enforce the TPA provisions more effectively, and that there were other means of achieving this:

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90 Mr David Forman, *Committee Hansard*, 11 April 2005, p. 20. See also CCC, *Submission* 14A, p. 8.

91 Mr Paul Budde, *Submission* 1, pp 1-2

92 Productivity Commission, *Review of National Competition Policy Reforms*, No. 33, February 2005.

93 Mr Doug Coates, *Submission* 2, p. 3.

94 Dr Mitchell Landrigan, *Committee Hansard*, 4 May 2005, p. 57.

> So putting in place penalties, which for example, would have to be of hundreds of millions of dollars to be in any sense meaningful, because Telstra fails to adequately deal with operational separation, or putting in place a divesture order because there is a failure to bring about operational separation, I might suggest with respect, tends to be focusing much more on the potential to do substantial damage to Telstra. Whereas it is far more important that we get the ultimate objective which is: clear, transparent and commercial arms-length dealings between Telstra's wholesale and retail operations. One of the simplest and certainly least damaging ways of achieving that is to have regulations that require those transparent accounting and commercial arms-length dealings to take place and to have those capable of being enforced by a court of law.[95]

6.89 Mr Samuel made clear that it is not a question of wanting divestiture powers; but rather a question of identifying effective means to achieve transparency.[96] ACCC Commissioner Mr Ed Willett expressed similar views.[97]

6.90 Those supporting divestiture powers often referred to the powers available to the United Kingdom regulator, OFCOM. As ATUG submitted:

> The UK context has strong incentives for the parties to agree an outcome - including, importantly, the ability of OFCOM to make a reference under the Enterprise Act to the Competition Commission for an assessment of appropriate remedies (de-merger) in the face of intractable market power arising from an enduring bottleneck in the local access area.[98]

6.91 Mr Paul Budde expressed similar views.[99]

6.92 However, as ACCC Commissioner Mr Ed Willett pointed out:

> … if OFCOM happen to find that the only way it could achieve what it is trying to achieve was through divestiture, then I think you would find the debate here might be very different. In those circumstances we probably would not want to rule out seeking a divesture power, but we are not in that situation.[100]

6.93 Mr Willett argued further:

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95 Mr Graeme Samuel, *Committee Hansard*, 9 May 2005, p. 13.

96 Mr Graeme Samuel, *Committee Hansard*, 9 May 2005, p. 14.

97 Mr Ed Willett, *Committee Hansard*, 9 May 2005, p. 14.

98 ATUG, *Submission* 20C, p. 5.

99 Mr Paul Budde, *Submission* 1, pp 1-2.

100 Mr Ed Willett, *Committee Hansard*, 9 May 2005, pp 14-15.

> We are not in the business of asking for powers that we are not sure we need to achieve the outcome. We have proposed some arrangements here which we think should be given some thought and could be effective.[101]

6.94 Nevertheless, the Committee considers that the grant of divestiture powers would strengthen the ACCC's capacity to deter anti-competitive conduct by giving it another tool with which to encourage compliance. Giving the ACCC a 'stick' as significant as a divestiture power would substantially improve the ACCC's negotiating power when attempting to address instances of large scale anti-competitive behaviour.

Recommendation 3

6.95 The Committee recommends that the ACCC be given divestiture powers.

Resources

6.96 The need for the ACCC to have sufficient resources to be an effective regulator has been raised frequently with the Committee, both during this inquiry and its inquiry into the establishment of the Australian Communications and Media Authority (ACMA).[102] The Communications Experts Group submitted:

> The ACCC has inadequate financial resources to defend a prolonged court case, the ACCC should have the resources to effectively construct a legal argument and obtain the required evidence to support by interacting with carriers, and if necessary providing financial support in preparing a case.[103]

6.97 Mr Richard Thwaites from ATUG also noted that inadequate financial resources may lead to a reluctance to take legal action:

> … we believe the ACCC needs considerably more resources than it currently has in order to mount its arguments and, therefore, to enable it to feel confident in making its judgments and taking them to appeal when necessary. We feel that the ACCC has done its best with the resources available for this sort of thing, but it has been under a severe disadvantage given the ability for it to be basically taken round and round the traps, with far greater resources applied to questioning its judgments. Naturally, this creates an environment of caution.[104]

6.98 The Townsville City Council submitted:

> Most importantly, any regulatory agency must be resourced appropriately to deal on an equal footing with one of the largest companies in Australia. Telstra has the resources to outlast and outgun the existing regulatory

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101 Mr Ed Willett, *Committee Hansard*, 9 May 2005, p. 15.

102 Senate Environment, Communications, Information Technology and the Arts References Committee, *A lost opportunity? Inquiry into the provision of the Australian Communications and Media Authority Bill 2004 and related bills and matters*, March 2005.

103 Communications Experts Group, *Submission* 26, p. 4.

104 Mr Richard Thwaites, *Committee Hansard,* 11 April 2005, p. 42.

> structure. An example of this was the time it took regulators to deal with the issue of Telstra's broadband wholesale pricing to competitors.[105]

6.99 In Perth, Dr Walter Green told the Committee:

> … both the ACA and the ACCC, in my instance, are under-funded to actually deal with these kinds of issues. They need a significantly larger staff to debate and discuss with the industry.[106]

6.100 Some witnesses argued that the ACCC was greatly under-resourced not only in financial terms but in staff expertise. As Dr Green stated:

> The ACCC have two problems. Firstly, they do not have the resources to deal with it properly…Their budget is continually being undercut. To me, they should be growing by eight to 10 per cent per year in their revenue over and above what I call a cost of living increase. In fact, we have the converse; it is going down. Secondly, it is a special set of skills that the ACCC has, so they have to consider staff retention and how that all operates as well. To me, they certainly need beefing up and need to be provided with both additional funds and additional regulatory control.[107]

6.101 AAPT also referred to the importance of appropriate staff.[108] Mr David Havyatt from AAPT told the Committee:

> It has become apparent to us that the ACCC does not have the resources to undertake the kind of ongoing analysis of the unfolding telecommunications markets that is needed for the regulation of this regime. We see that repeatedly in the nature and structure of inquiries that emerge under the regime—there is no coherent whole-of-ACCC thinking unfolding.[109]

6.102 Mr Havyatt argued for a full-time ACCC commissioner dealing with telecommunications, so as to ensure that the sector was adequately scrutinised:

> That commissioner should also be a member of the Australian Communications and Media Authority. So there would be one person who was really spending their time looking at this, and not the chairman and a commissioner doing it as a part-time activity and occasionally weighing into the consideration of telecommunications issues.[110]

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105 Townsville City Council, *Submission* 34, p. 2.

106 Dr Walter Green, Communications Experts Group, *Committee Hansard*, 29 April 2005, p. 19.

107 Dr Walter Green, Communications Experts Group, *Committee Hansard*, 29 April 2005, p. 30.

108 AAPT, *Submission* 13, p. 8.

109 Mr David Havyatt, *Committee Hansard*, 11 April 2005, p. 30.

110 Mr David Havyatt, *Committee Hansard*, 11 April 2005, p. 30.

6.103 The ACCC has a Chairman, a Deputy Chair and five full-time Commissioners.[111] The Committee agrees that, given the importance of telecommunications and the separate regime established in the TPA for telecommunications regulation, it would be desirable to have one commissioner with particular responsibility for telecommunications. The Committee also agrees that this person should be a member of the Australian Communications and Media Authority (ACMA) so as to facilitate sharing of knowledge between the two organisations.[112]

Recommendation 4

6.104 The Committee recommends that one of the full-time commissioners of the ACCC be given specific responsibility for telecommunications, and that this person also be a member of the Australian Communications and Media Authority.

6.105 Earlier this year the Committee recommended that funding to the ACCC for telecommunications competition issues be substantially increased as a matter of urgent priority, given the need for the regulator to be well-resourced in order to be effective.[113] In light of the evidence it has received in this inquiry, especially with respect to the ACCC's conduct of the broadband competition notice and the Mobile Terminating Access Services declaration, the Committee repeats that recommendation.

Recommendation 5

6.106 The Committee recommends that funding to the ACCC for telecommunications competition issues be substantially increased as a matter of urgent priority.

The role of the ACCC

6.107 This Committee has discussed at length the ACCC's responsibilities for managing anti-competitive practices and protecting consumers. The Committee heard concerns that sometimes these two functions appear to be in conflict. As Mr David Spence from Unwired Australia stated:

> One of the issues is that the ACCC is the consumer council and the competition council. The Telstra drop of broadband prices to $29.95 may have been very good for consumers and certainly improved the take-up rate, but it may not be in the best long-term interests from a competition point of

111 As well as several associate and ex-officio members and a Chief Executive Officer.

112 The Committee previously recommended cross-membership of the ACMA and ACCC boards – see Senate Environment, Communications, Information Technology and the Arts References Committee, *A lost opportunity? Inquiry into the provisions of the Australian Communications and Media Authority Bill and related bills and matters,* 2005, Recommendation 7.

113 Senate Environment, Communications, Information Technology and the Arts References Committee, *A lost opportunity? Inquiry into the provisions of the Australian Communications and Media Authority Bill and related bills and matters,* 2005, Recommendation 10 & pp 65-68.

> view. If Telstra were to do that in order to dominate the market in the next couple of years and eliminate all alternative infrastructure providers, then that is not the best competition in the place. I believe that, if you look at competition regulatory bodies around the world, you do not often find them tied up with the consumer council as well… It would be hard for the ACCC to say to Telstra, 'Put the prices back up again from $29.95,' when they are the consumer council.[114]

6.108 However, the Committee notes that the object of fostering competition is to promote the long term interests of end users. The main problem that has become apparent during this inquiry is the ACCC's inability to regulate anti-competitive practices adequately, and this has obvious effects on consumers. The Committee does not support taking consumer protection functions from the ACCC, noting that the former ACA (now the ACMA) also has important responsibilities in that area, as discussed below.

6.109 The Committee also heard criticism of the ACCC's involvement in policy. Mr Bill Scales from Telstra stated:

> If you have a regulator which is clearly determined to become involved in the policy debate and is clearly determined to ensure that its policy outcomes are achieved, then automatically what follows from that is the potential moral hazard of the regulator establishing outcomes will ensure that that follows…They are a natural consequence of trying to achieve a policy outcome.[115]

6.110 AAPT submitted that policy reviews were more appropriately carried out by the department rather than the regulator, and called for additional resources for the department's policy work and policy research, noting:

> Departmental review does not preclude the views of the regulator being sought. During the period of reform in the 1980s and 1990s many of the developments were driven by the research of the Bureau of Transport and Communications Economics, which in part continues as the Communications Research Unit.[116]

6.111 However, in defence of the ACCC, Chairman Mr Graeme Samuel argued:

> We do not get involved in policy debates unless we are either requested to provide opinions on policy by government or asked our views by parliament and parliamentary committees, and then there are the limitations the chair described. We are a regulator. We are intimately involved with the regulation of the telecommunications industry, with one fundamental objective, and that is to bring about a competitive environment in the short- to medium- and long-term future. We will continue to do so. Where it is

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114 Mr David Spence, *Committee Hansard*, 13 April 2005, p. 115.

115 Mr Bill Scales, *Committee Hansard*, 4 May 2005, p. 71.

116 AAPT, *Submission* 13, p. 10.

> necessary for us to express opinions as to our regulatory responsibilities, we will continue to do so.[117]

The TPA: Part XIB and section 46

6.112 In Chapter 3 the Committee discussed the criticisms that Part XIB of the TPA does not adequately define anti-competitive conduct in telecommunications, particularly in light of the issues that surfaced during the 2004 ADSL competition notice. In brief, section 151AJ defines anti-competitive conduct as a situation where a carrier or carriage service provider has a substantial degree of market power and takes advantage of that power with the effect, or likely effect, of substantially lessening competition.

6.113 Several witnesses argued that the ACCC must be empowered to prevent Telstra from engaging in conduct that may constitute misuse of market power or the reduction of competition in the telecommunications market. There was a range of suggestions as to how the legislation might be changed.

6.114 The Communications Experts Group argued that proof of certain behaviours should suffice in itself, instead of needing also to prove the detrimental effect of the behaviour:

> In many cases the ACCC ha[s] to prove that a certain behaviour is unacceptable, and that the alleged offender caused or undertook the unacceptable behaviour e.g. offering retail prices below wholesale prices for some services. There are a number of cases where unacceptable behaviour should be specified, so that the ACCC only has to prove the unacceptable behaviour.[118]

6.115 Optus also criticised the test in Part XIB, proposing in its place a 'non-discrimination rule' about price (that is, a prohibition against 'unreasonable' discrimination on providing listed carriage services):

> The non-discrimination rule (NDR) will mean that instead of competitors having to demonstrate that Telstra's behaviour is anti-competitive by substantially lessening competition, Telstra would need to demonstrate that it was not behaving in a discriminatory manner, so complying with the NDR. This is an important change that shifts the onus of proof onto Telstra to demonstrate compliance with the rule, rather than the much higher test for non-Telstra providers to demonstrate that Telstra is not only behaving anti-competitively, but that this behaviour is having a significant impact on competition.[119]

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117 Mr Graeme Samuel, ACCC, Senate Economics Legislation Committee, *Additional Estimates Hansard*, 17 February 2005, p. 10.

118 Communications Experts Group, *Submission* 26, p. 4.

119 Optus, *Submission* 12, p. 22.

6.116 The Committee notes that Optus' suggestion of a 'non-discrimination rule' is similar in some ways to the UK's regulatory requirements imposed on telecommunications providers with significant market power (SMP).[120] Non-discrimination principles are applied to avoid or, at least, minimise market distortion by those with market power, including vertically integrated organisations that supply to internal and external customers.

6.117 Designated SMP providers must supply products at the same price to external customers as to their internal retail arms, unless differences are 'objectively justifiable'. The non-discrimination obligations in the UK also extend to non-price differences, including the 'timing of provision', the 'functionality of the product supplied', 'the reliability and efficiency of transactional processes', and the availability of relevant product information.[121] Again, the terms and condition of product supply to external customers must be the same as the terms and conditions of product supply to an SMP provider's retail arm, unless the differences are objectively justifiable.

6.118 The Committee notes that the UK regulator, OFCOM, is currently reviewing its approach to investigating potential contraventions of the requirement not to unduly discriminate.[122] The Committee considers that these developments should be examined closely in considering future options for the anti-competitive regime in Australian telecommunications. It may be that imposing a positive duty on all industry participants with 'significant market power' not to discriminate unduly would be beneficial. However, this is not quite the same as reversing the onus of proof in individual cases, as the Optus submission seems to suggest.

6.119 The Committee heard another suggestion about possible legislative amendment, to address the concern about the requirement in section 151AJ to establish that a corporation 'takes advantage' of its market power. Unwired Australia submitted:

> Telstra's position in the market means that any actions it takes, regardless of its purpose in taking them, and whether or not it 'takes advantage' of its position to take them, have dramatic impacts on its competitors. If negative impacts are to be controlled, the provisions should be amended to remove 'takes advantage of that power' as follows to simply refer to a corporation acting with the prohibited effect.[123]

6.120 However, the Committee considers that this suggestion if implemented would broaden the operation of section 151AJ to an unacceptable level. The Committee

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120 The UK requirements not to unduly discriminate are derived from European Directives. See OFCOM, *Undue discrimination by SMP providers*, consultation paper, 30 June 2005, p. 11, accessed at: http://www.ofcom.org.uk/consult/condocs/undsmp/.

121 OFCOM, *Undue discrimination by SMP providers*, consultation paper, 30 June 2005, p. 10, accessed at: http://www.ofcom.org.uk/consult/condocs/undsmp/.

122 A consultation paper was released on 30 June 2005, with responses due by 8 September 2005.

123 Unwired Australia, *Submission* 48, p. 3.

notes that a recent Senate committee report on section 46 of the TPA, referring to various High Court and Federal Court decisions, recommended the insertion of a declaratory provision listing factors to be taken into account in determining whether a corporation has taken advantage of its market power.[124] The ACCC had submitted that a court should consider whether: the conduct of the corporation is materially facilitated by its substantial degree of market power; the corporation engages in the conduct in reliance on its substantial degree of market power; the corporation would be likely to engage in the conduct if it a lacked substantial degree of market power; or the conduct of the corporation is otherwise related to its substantial degree of market power.[125] The report recommended the declaratory provision should be based on those suggestions.[126]

6.121 The Committee considers that such a provision may also be helpful in relation to Part XIB.

Recommendation 6

6.122 The Committee recommends that section 151AJ of the *Trade Practices Act 1974* be amended by inserting an inclusive list of factors to be considered by the courts in determining whether a carrier or carriage service provider has taken advantage of its substantial degree of power in a telecommunications market.

6.123 The Committee notes that Part XIB was never intended to be a permanent part of the TPA. However, it is clear that there are still serious concerns about anti-competitive conduct. Accordingly, the Committee considers that any suggestion that the ACCC should rely only on its general powers under Part IV in the telecommunications market cannot be sustained.

6.124 In any case, the Committee heard concerns about the operation of Part IV. Section 46 relating to general misuse of market power prevents a corporation with a substantial degree of market power from taking advantage of that power for the purpose of eliminating or substantially damaging a competitor, preventing the entry of a person into any market, or deterring or preventing competitive conduct in a market. The Committee heard that the 'purpose test' is 'notoriously difficult to establish'.[127]

6.125 Consistent with its argument about the Part XIB provisions, Unwired suggested that the 'purpose test' in section 46 should be replaced with a test focusing

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124 Senate Economics References Committee, *The effectiveness of the Trade Practices Act 1974 in protecting small business*, March 2004, Recommendation 2.

125 Senate Economics References Committee, *The effectiveness of the Trade Practices Act 1974 in protecting small business*, March 2004, p. 14.

126 Senate Economics References Committee, *The effectiveness of the Trade Practices Act 1974 in protecting small business*, March 2004, p. 15.

127 Unwired Australia, *Submission* 48, p. 2.

on the outcome or effect of the action.[128] However, Dr Mitchell Landrigan from Telstra argued that 'purpose' has generally been either conceded or quite easily proven:

> I think the current position about that debate is that it is quite redundant given that most of the High Court decisions in which concerns have been raised about whether section 46 has worked have not been about purpose. Purpose has generally been either conceded or quite easily proven, largely because of provisions that are built into section 46. The taking advantage of market power component has been the subject of some detailed debate with some measures proposed about whether indicia about what market power is should be built into the legislation.[129]

6.126 Any changes to Part IV would have implications that range far beyond the telecommunications industry. In light of the ACCC's access to special provisions in Part XIB, the Committee does not recommend any changes to Part IV.

The TPA: Part XIC

6.127 The Committee considers that the administration of the TPA has a potential dampening effect on investment in infrastructure services because of the risk of exposure to access regulation, particularly where there is a risk that regulated returns may not provide a sufficient return on investment. In reaching this view, the Committee is mindful that the benefits of competition in the services sector will be available over the longer term only if there is ongoing investment in the infrastructure that provides those services.

6.128 Another element which the Committee is convinced is having a damaging effect on investment in infrastructure by new entrants is Telstra's behaviour. The Committee has identified at least two ways that this arises: by impeding access to its network on satisfactory terms, so that access seekers cannot build customer bases and profitable businesses sufficient to enable investment in their own facilities; and in the way it directly responds to facilities competition.

6.129 That Telstra can impede access would suggest that the access regime is not working in accordance with the intent expressed in the Competition Principles Agreement between the Commonwealth and the States. The Committee notes that the Agreement provides that legislation with the following effects should be implemented:

> 6(4)(m) The owner or user of a service should not engage in conduct for the purpose of hindering access to that service to another person.
>
> 6(4)(e) The owner of a facility that is used to provide a service should use all reasonable endeavours to accommodate the requirements of a person seeking access.

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128 Unwired Australia, *Submission* 48, p. 2.

129 Dr Mitchell Landrigan, *Committee Hansard*, 4 May 2005, p. 57.

6.130 The thrust of these requirements would appear to be effected by section 152EF of the TPA, which prohibits the hindering of the fulfilment of the standard access obligations. Notwithstanding this provision, however, the Committee heard much evidence of behaviour that seems to fall squarely within the prohibition.

6.131 The Committee has heard evidence of attempts by some firms to respond to demand by delivering services, or building or attempting to build, alternative facilities. Almost invariably, such efforts have been impeded by Telstra.

6.132 The Committee has heard evidence of Telstra overbuilding infrastructure—or dropping its prices for existing services—in response to a threat from potential facilities competitors. Not only does this action block that particular competitor, but it sends a clear signal to the market about how Telstra is likely to respond to similar initiatives.

6.133 The Committee also heard evidence that the cost of transmission—a declared service on many of the routes in question—was too high to justify investment in facilities or services in many markets and, most notably, regional areas.

6.134 It is apparent from these examples and from other evidence received during this inquiry that as long as Telstra has both the incentive and ability to favour itself over competitive service providers, a rigorous access regime is still needed.

6.135 The Committee believes that the access regime should be focussed on bringing about more timely and acceptable resolution of access requests. To this end, the Committee considers that the regime should include not just measures designed to reduce the ability of access providers to impede—or unreasonably delay—access but should also aim to reduce the incentive for it.

6.136 The Committee considers that the object of Part XIC of the TPA should remain the promotion of the long term interest of end users. However, the Committee considers that the objectives to which the ACCC must have regard in determining whether that object is promoted (in section 152AB) need to be weighted differently. In the Committee's view, the objectives of promoting competition in downstream markets and achieving any-to-any connectivity will not be achieved in the long term unless there is continuing investment in infrastructure services. For this reason, the Committee considers that the third objective in subsection 152AB(2)—encouraging the economically efficient use of, and the economically efficient investment in, infrastructure—should be given primacy.

6.137 The Committee notes that the Government has proposed that the objective of the general access regime in Part IIIA be 'to promote the economically efficient operation of, use of and investment in the infrastructure by which services are provided, thereby promoting effective competition in upstream and downstream markets'.[130]

130 Paragraph 152AB(e).

Recommendation 7

6.138 The Committee recommends that the third objective of the access regime as set out in subsection 152AB(2) of the *Trade Practices Act 1974*—encouraging the economically efficient use of, and the economically efficient investment in infrastructure—be given primacy.

6.139 As discussed in Chapter 4, it appears that the access regime is not working in accordance with the intent expressed in the Competition Principles Agreement between the Commonwealth and the States. Accordingly the Committee makes the following recommendations.

Recommendation 8

6.140 The Committee recommends that in order to clearly satisfy the Commonwealth's obligations under clause 6(4)(e) of the Competition Principles Agreement, the *Trade Practices Act 1974* be amended to include a provision that requires the owner of a facility that is used to provide a service to use all reasonable endeavours to accommodate the requirements of a person seeking access.

Recommendation 9

6.141 The Committee recommends that to clearly satisfy the Commonwealth's obligations under clause 6(4)(m) of the Competition Principles Agreement, section 152EF of the *Trade Practices Act 1974* be amended to prohibit conduct that has the effect—and not just the purpose—of preventing or hindering the fulfilment of a standard access obligation or an obligation imposed by a determination made by the ACCC under Division 8.

6.142 The Committee notes that the ACCC has power to determine model terms and conditions in relation to 'core services'. The core services are listed in section 152AQB and can be expanded by regulation.[131]

Recommendation 10

6.143 The Committee recommends that the Government consider expanding the class of 'core services' in relation to which the ACCC must determine model terms and conditions for access. In particular, the Committee recommends that for the purpose of improving services in regional areas, certain transmission (or backhaul) routes be specified in the regulations as 'core services' under section 152AQB of the *Trade Practices Act 1974*.

6.144 The Committee notes that the ACCC has already indicated its intention to make variations to 2003 Model Core Services Terms and Conditions Determination for the Unconditioned Local Loop Service. The Committee notes the evidence that the practice of delaying access to declared services seems to be common. While

131 Paragraph 152AQB(1)(e).

Recommendation 9 above addresses this issue, it necessitates legislative change which may take some time. The Committee considers that the matter may be dealt with more expeditiously in any model terms determined by the ACCC.

Recommendation 11

6.145 The Committee recommends that the ACCC include prohibitions on behaviour that has the purpose or effect of impeding or unreasonably delaying access in any model terms and conditions for core services—and particularly those relating to the unconditioned local loop service.

Recommendation 12

6.146 The Committee recommends that the *Trade Practices Act 1974* be amended to require the ACCC to give greater importance to model terms and conditions in arbitrations. In addition to the ACCC merely 'having regard to' model terms and conditions determinations, such determinations should apply presumptively unless the parties can show good reason to depart from them.

6.147 At the very least, the ACCC should have an influence over price sooner in the process, that is, prior to an access dispute arising. The Committee does not have a view about the method by which the prices are set, although, in relation to transmission prices in regional areas where there would appear to be the least prospect of competition emerging to solve the access problem, prices should be more tightly controlled. The Committee notes the view of the Western Australian Department of Industry and Resources that distance based tariffs should be replaced with volume based tariffs.

Recommendation 13

6.148 The Committee recommends that the ACCC be granted powers to set prices in addition to, or instead of, developing pricing principles.

Recommendation 14

6.149 The Committee recommends that subsection 152AQA(6) of the *Trade Practices Act 1974* be amended to require the ACCC to have regard to its pricing principles when it is assessing undertakings as well as in the arbitration of access disputes as is presently provided.

6.150 The Committee favours the approach taken in Part IIIA of the TPA, which allows the ACCC to require the giving of an undertaking and gives it the power to amend undertakings or substitute its own.

Recommendation 15

6.151 The Committee recommends that subsection 152AQB(6) of the *Trade Practices Act 1974* be amended to require the ACCC to have regard to any model terms and conditions when it is assessing undertakings as well as in the arbitration of access disputes as is presently provided.

Recommendation 16

6.152 The Committee recommends that further amendments be made to the undertakings scheme to prevent or discourage their use to delay access and to bring more certainty to the market. In particular, the Committee recommends the imposition of shorter target timeframes in relation to access decisions.

6.153 By way of example, the Committee suggests the following targets:

- sections 152AT and 152ATA of the *Trade Practices Act 1974* be amended to require decisions on ordinary and anticipatory exemptions to be made within a period shorter than 6 months.
- sections 152BU and 152CBA of the *Trade Practices Act 1974* be amended to require decisions on ordinary and special access undertakings to be made within a period shorter than 6 months;
- section 152CF of the *Trade Practices Act 1974* be amended to require the Australian Competition Tribunal to make decisions within a period shorter than 6 months. The Committee notes that such a change has been proposed in relation to decisions of the Tribunal under part IIIA.

6.154 The Committee also notes that it is important that the ACCC has adequate resources to fulfil these requirements, and reiterates its call for further funding for the ACCC as set out in Recommendation 5.

6.155 The Committee considers that the need for legislated 'access holidays' has not been demonstrated and therefore supports continuation of the present scheme. The Committee agrees with the ACCC's view that the overturning of the Foxtel/Telstra exemption turned on the particular facts of that case and did not reflect a flaw in the exemptions scheme or prevent the ACCC from making exemptions in the future.

Recommendation 17

6.156 The Committee recommends that the present scheme of anticipatory exemptions and special undertakings remain unchanged for the time being.

Foxtel and the HFC

6.157 In its 2003 report on *Emerging market structures in the communications sector,* the ACCC discussed at some length the incentive for anti-competitive behaviour arising from Telstra's half ownership of Foxtel and its ownership of the HFC network on which it is delivered. The ACCC's specific concerns are that Telstra has full ownership of the main HFC pay TV distribution network and a copper network, as well as a 50 per cent shareholding in the major pay TV operator in Australia. This ownership has specific effects, as the ACCC stated:

> Telstra's ownership of a HFC network:
>
> - diminishes opportunities for competition by actual and potential network competitors

- means Telstra's copper and HFC networks do not compete with each other denying potential price and service benefits that such competition could deliver to consumers.

Telstra's partial ownership of Foxtel provides it with the incentive to:

- foreclose supply of pay TV channels by Foxtel to other networks competing with Telstra for the supply of telecommunications services
- prevent other pay TV businesses or channels from gaining access to Telstra's HFC network.[132]

6.158 In relation to Foxtel, the ACCC noted:

> Through its partial ownership of Foxtel, Telstra has the ability to veto supply of pay TV channels by Foxtel to other networks. Foxtel and Telstra also have an interest in preventing other pay TV businesses or channels from gaining access to Telstra's fixed customer access network. Therefore, Telstra is in a position where it controls important inputs of supply for its potential and actual broadband network competitors, as well as for pay TV operators competing against Foxtel (on the Telstra HFC network).[133]

6.159 The report noted that Foxtel is presently supplying content to other carriers, and that proposed access to content arrangements will help to facilitate this further. Telstra's influence on these agreements remains and access regulation will only go so far to reduce this influence. The ACCC concluded that requiring Telstra to divest its Foxtel shareholding would remove Telstra's influence in preventing Foxtel supplying its pay TV channels (particularly premium channels) to other networks. Divestiture would also be likely to make Telstra more willing to allow other pay TV businesses or channels access to Telstra's HFC network (in the event it is not divested).[134]

6.160 The ACCC also considered Telstra should divest itself of its HFC network because Telstra owns two of the three major fixed telecommunications networks. As firms do not compete with themselves, Telstra's continuing focus is not to maximise the revenue from each network separately but rather to maximise revenue across both networks. Therefore, in seeking to protect the revenues of both networks, investment will not be made, or will be delayed, in services that would cannibalise the revenue of the other network. For example, Telstra does not seek to supply telephony services on its HFC network which would reduce the revenue that Telstra receives from its PSTN network:

> Divestiture of the HFC would introduce a new infrastructure competitor into the market, creating conditions for increased rivalry and innovation in the supply of a full range of telecommunications services, including broadband services. The Commission believes that if the HFC is divested, divestiture of Foxtel would become even more important so that Telstra

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132 ACCC, *Emerging market structures in the communications sector*, June 2003, p. 39.

133 ACCC, *Emerging market structures in the communications sector*, June 2003, p. xviii.

134 ACCC, *Emerging market structures in the communications sector*, June 2003, p. xxii.

> could not use its influence in Foxtel to deny the new network owner access to Foxtel pay TV content.[135]

6.161 ATUG submitted:

> The OECD's conclusion on ownership of cable and copper networks and competition in broadband is clear, "... the broadband markets in one third of OECD countries are being held back where the cable networks are not providing independent competition with the PSTN. This is evident in the difference in level of service, pricing and take-up of service. In these cases all options need to be considered to increase the level of competitive provision of broadband access including separating cable networks from incumbent PSTN operators".[136]

6.162 The Committee notes that the OECD in an Economic Survey report in December 2004 also recommended that Telstra be required to divest the HFC network and its shareholding in Foxtel on the basis that there was 'no effective competition in pay TV'.[137] An earlier OECD report also stated:

> Evidence continues to show that ownership of cable networks, by incumbent telecommunication carriers, leads to a slower roll out of broadband access. Overall broadband growth rates are clearly higher where there is head to head competition between independently owned DSL and cable networks.[138]

6.163 Mr Charles Britton from the Australian Consumers' Association agreed there was a need for Telstra to divest itself of both its share in Foxtel and of its HFC network. Mr Britton also noted the positive effect on competition and infrastructure investment of cable companies' and copper line telcos' competition in the United States:

> … you have a structural competition driver in the United States where the cable companies are in competition with the established copper line telcos and are driving voice over IP as a competitive offering in the marketplace. We are not going to see anything like the same structural pressure behind the rollover voice over IP because we do not have the facilities competition that has emerged between cable and DSL and we do not have the drivers that are going to produce it.[139]

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135 ACCC, *Emerging market structures in the communications sector*, June 2003, p. 30.

136 ATUG, *Submission* 20C, p. 9.

137 OECD Economic and Development Review Committee, *OECD Economic Surveys: Australia*, December 2004, p. 114. The report noted that 'This dominant position is disquieting' and made recommended divestiture 'provided independent assessment shows the benefits of divestiture would exceed the costs' (p. 114).

138 OECD Working Party on Telecommunications and Information Services Policies, *Broadband access for business*, December 2002.

139 Mr Charles Britton, *Committee Hansard*, 13 April 2005, p. 61.

6.164 The Australian Consumers' Association argued the need for divestiture prior to the sale of Telstra:

> In our view the requirement that Telstra divest itself of the HFC cable network and the Foxtel service that it carries is an essential pre-requisite to privatisation, in order to curb the horizontal sprawl of the corporation into media, and the exercise of market power into both spheres in a mutually reinforcing way that will over time deliver significant monopoly benefits for the company and consequent detriment to consumers.[140]

6.165 Mr Paul Budde went further in proposing that Sensis and Foxtel should be amalgamated prior to divestiture:

> 'Let's hive off Sensis from Telstra, put the Foxtel shareholding in that and actually create a media company.' That would solve a lot of problems. The value of Telstra will not be diminished by Sensis, because there is no synergy between Telstra and Sensis. If Sensis is not there, the mobile, broadband or voice divisions are not suddenly going to be different—not at all. If you unshackle Sensis, I guarantee it will increase rather than reduce in price. So it would be great for the shareholders who the government wants to look after. You are then creating a situation where you start pushing in the direction of structural separation, without forcing it in that very rigid way that some of the commentators are talking about and that we do not want. You would actually be pushing it in the right direction and then you would start seeing that if you start opening up that market, Telstra without Foxtel would become far more involved in what is called broadband television, IPTV.[141]

6.166 Mr Budde also argued that such a model would create competition in the media sector.

6.167 The Committee notes the CEPU's opposition to this proposal,[142] but believes that competition in the telecommunications market would be enhanced if Telstra were required to divest itself of its share in Foxtel and of its ownership of its HFC network, as it has previously recommended.[143]

6.168 The Committee heard evidence that ownership of both the cable and copper network by a fully privatised Telstra, whose goal would be maximising shareholder value and not national interest, would be disastrous for competition and innovation. Telstra would continue to squeeze the maximum value out of the 100% owned copper network, staving off competition in the HFC network. As this behaviour would be difficult to regulate, the Committee believes that if privatised Telstra should be

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140 Australian Consumers' Association, *Submission* 16, pp 10-11

141 Mr Paul Budde, *Committee Hansard*, 13 April 2005, p. 52.

142 CEPU, *Submission* 40, p. 22.

143 Senate Environment, Communications, Information Technology and the Arts References Committee, *Competition in broadband services*, 2004, Recommendations 4 and 6.

required to divest the HFC cable. If on the other hand Telstra remained in public hands, the Government as majority shareholder could play a greater role in encouraging access to both networks, although the Government has been reluctant in the past to be involved in strategic and operational decisions. The Committee believes that further consideration would need to be given to the merits of divesting the HFC cable while Telstra remained in majority public ownership.

Recommendation 18

6.169 The Committee recommends that Telstra be required to divest its shareholding in Foxtel.

Recommendation 19

6.170 The Committee recommends that:

(i) if Telstra is fully privatised, it be a condition of the sale that Telstra be required to divest its HFC network; and

(ii) if Telstra remains in public hands, the Government direct the Australian Competition and Consumer Commission to provide further advice on its recommendations in its report *Emerging Structures in the Communications Sector* that Telstra be required to divest itself of its HFC network.

Investment in infrastructure

6.171 In chapters 4 and 5 the Committee discussed concerns that a large percentage of the Government's HiBIS funding, designed to promote infrastructure competition in regional Australia, was going to Telstra to upgrade its regional network and that there is growing concern in regional and rural Australian about the future of the USO.

6.172 In regional NSW the Committee was told about the presence of unused telecommunications infrastructure in the form of 'dark fibre', that is, fibre optic cable which is not activated. As discussed in Chapter 4, Telstra asserted that dark fibre was laid to accommodate future demand or serve as a back-up if activated cable were damaged. In north Queensland, representatives from James Cook University referred to a separate fibre optic network which runs from Brisbane through to Townsville, a distance of over 1500 kilometres. The Committee formed the opinion that in populated corridors of Australia there is currently a range of optic fibre infrastructure. Much of this infrastructure is owned by State and Territory governments, government authorities, and local councils and utilities, and some of this infrastructure is still dark. Attempts by the Committee to seek a clearer national picture of this infrastructure were largely unsuccessful. The Committee believes that in order to stimulate

infrastructure-based competition, an accurate national picture of what currently exists must be established.[144]

6.173 Mr Malcolm Moore provided the Committee with an outline of a model for increasing telecommunication facilities in regional Australia. However, he pointed out that for this to be achieved:

> … it is essential to identify if there is any optical fibre linking any of these areas, and these actual fibre routes need to be identified. It does not matter who owns this fibre and if it is in use or not …[145]

Recommendation 20

6.174 The Government should undertake a mapping exercise of optic fibre networks in Australia. Particular consideration should be given to mapping of 'dark' fibre and infrastructure owned by government authorities, local councils and utilities.

Meeting consumer demands

6.175 While the Telecommunications Act states that one of the main objects of the regulatory regime is to promote the 'long term interests of end users', the Committee heard many times during this inquiry that the self-regulatory regime has failed to give consumers adequate protection. Moreover, the Committee heard repeated criticism of the USO, particularly in rural and regional areas, in terms of the range and reliability of current services. Access to broadband is now considered a vital part of many businesses in rural and regional areas, but problems of availability, reliability and cost are apparent in many areas.

The Universal Service Obligation

6.176 As discussed in Chapter 5, a key criticism of the USO is that it only allows for the provision of a Standard Telephone Service (STS) and the 'legitimate expectations of the Australian community' now go beyond a copper wire voice service. Another criticism is the costing and funding arrangements that require telecommunication service providers to subsidise the Universal Service Provider, Telstra.

6.177 The Committee notes the suggestions that broadband should become an integral part of the USO and could be used to explore future opportunities in the USO

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144 The Committee notes that a similar recommendation was made in an earlier report: ' The ACA should be empowered and required to develop a comprehensive inventory of all significant telecommunications infrastructure, including geospatial data on Telstra's existing customer network and mobile phone coverage, and make that information available to other carriers and service providers, local government, and other interested parties to facilitate planning for new infrastructure.' See Senate Environment, Communications, Information Technology and the Arts References Committee, *The Australian telecommunications network*, August 2004, p. 148.

145 Mr Malcolm Moore, *Submission* 6C, p. 18.

environment.[146] However, the Committee notes that there has been no attempt to analyse the costs of providing this service to all users on request, and considers that other policy options are available, as discussed in the next section.

6.178 The Committee also acknowledges that further broadening of the USO would exacerbate conflicts about how the USO should be funded. Telecommunications providers argue that the levy is another obstacle to expanding their broadband services in regional and remote Australia, while Telstra argues that it is subsidising the USO.

6.179 This inquiry heard strongly conflicting views over whether the current funding arrangements should continue or whether Telstra should fund the existing USO. The Committee notes in particular DCITA's recommendation in 2004 that Telstra should fund all costs associated with the traditional STS provision, and that this recommendation has not been implemented. However, USO subsidies have been steadily reduced from $240m in 2001-02 to a projected $145m by 2007-08. Consequently the imposition on other industry participants has been reduced significantly. The Committee considers that the Government should review the basis of the funding in two to three years time, prior to the setting of the next three years of USO subsidies. By that time, other regulatory measures will be in place and there may be new or different considerations.

Recommendation 21

6.180 The Committee recommends that the Government review the basis of funding for the Universal Service Obligation prior to setting the subsidies for the next three year cycle to commence from 2007-08.

Broadband

6.181 In recent years, the community's demands for access to telecommunications have increased. To have equality of access for all Australians now means equality of access to broadband, as the Broadband Advisory Group's Report to Government recognised in January 2003. The report states:

> The principal challenges are geographic considerations, technological limitations and availability, perceptions about price and the value proposition of broadband and the need for a national strategic approach to broadband rollout…The Government should promote investment in those areas of Australia that are likely to remain underserved purely by the private sector. As identified in the Estens Inquiry, rural and regional areas are a priority. The development of demand aggregation strategies should be used to assist in this process.[147]

146 For example, Mr Paul Budde, *Committee Hansard*, 13 April 2005, p. 47.

147 *Australia's Broadband Connectivity: The Broadband Advisory Group's Report to Government*, Chapter 10, accessed 28 June 2005 at: http://www.dcita.gov.au/ie/publications/2003/01/bag_report/chap10.

6.182 The Higher Bandwidth Incentive Scheme (HiBIS), funded by the federal government, has gone some way towards providing broadband to rural and regional areas. However, as noted in Chapter 5, witnesses indicate that monthly payments are too costly for rural and regional Australians[148] and some service providers do not sign up to the scheme because of recurring costs.[149]

6.183 The Committee takes particular note of the fact that an equitable roll out of broadband services is of importance to Australians living in rural, regional and remote areas, and that a strategy is required to achieve universal access. As the CEPU states:

> Contrary to the wishful thinking of the Page Report, there are no short cuts to an equitable broadband future.[150]

6.184 The Committee further notes that at the recent Regional Telecommunications Forum in Sydney, representatives of 25 regional cities called for high-capacity broadband infrastructure across Australia by 2010. Delegates agreed that 'access to high-speed broadband was 'absolutely critical' to ensure Australia remained globally competitive'.[151] The group aims to work with the Federal Government to achieve this goal.

Recommendation 22

6.185 The Committee recommends that the Government carry out a cost analysis of the Higher Bandwidth Incentive Scheme (HiBIS) immediately to ascertain how equitable universal broadband access can be ultimately provided.

6.186 The Committee recognises that there are no regulatory requirements in place for the rollout of any infrastructure other than the mobile infrastructure.[152] This results in 48.9% of HiBIS customers currently being supplied by satellite,[153] which is the highest proportion of all the methods available to deliver broadband. Satellite delivery does not create an infrastructure that would otherwise provide opportunities for a greater number of customers in a local area to access broadband. This does not allow the Demand Aggregation Policy to deliver the required outcomes; it should be urgently reviewed.[154]

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148 Mr Gary Chappell, Peel Development Commission, *Committee Hansard,* 29 April 2005, p. 67.

149 Mr Stephen Dalby, iiNet, *Committee Hansard,* 29 April 2005, p. 39.

150 CEPU, *Submission* 40, p. 30.

151 Mr Harvey Grennan, 'Give us broadband in five years', *The Sydney Morning Herald*, 5 July 2005, p. 23.

152 Mr Horsley, ACA, *Committee Hansard*, 4 May 2005, p. 46.

153 DCITA, update of answer to Question on Notice 141, tabled 24 May 2005 at Environment, Communications, Information Technology and the Arts Legislation Committee *Budget Estimates* hearing; and see Environment, Communications, Information Technology and the Arts Legislation Committee *Budget Estimates Hansard*, 24 May 2005, p. 105.

154 Mr Paul Budde, *Submission* 1, p. 11.

6.187 Mr David Spence from Unwired Australia stated that:

> We believe that encouragement of other medium sized and smaller companies to roll out in regional Australia is beneficial for future competition and prices in the market. For instance, there is the HiBIS fund at the moment for broadband in rural and regional Australia, and Telstra gets most of the HiBIS funding. We believe it would be better in the long term for that funding to go to companies other than Telstra.[155]

6.188 The Committee notes that the Government has put a ceiling on Telstra's eligible claim on the HiBIS funds at 60%.[156] Latest figures available, as at 23 May 2005, indicate that Telstra has received $25.218m of the total $39.353m of the HiBIS subsidy claimed to that date.[157] Telstra has 11,233 customers using broadband in the scheme. The nearest HiBIS provider is BorderNet, whose claims amount to $2.95m (1179 customers) to the same date.[158]

6.189 The Committee considers that to create broadband competition, providers should be given incentives to apply for registration as a broadband service provider through the HiBIS. The Committee believes that incentives that favour proposals which create broadband infrastructure, rather than proposals that simply provide broadband to a single customer through satellite, would result in more opportunities for consumers to get access to broadband.

6.190 The Committee notes that the current HiBIS Program Guidelines state:

> The HiBIS Service Area may also be defined by the locations to which it is technically or financially feasible to offer the proposed HiBIS Service, rather than by a discrete geographic area. For example, a HiBIS Provider providing HiBIS Services via satellite may define its HiBIS Service Area to include those Premises only serviceable by satellite solutions.
>
> HiBIS Service Areas must be within the HiBIS Area.
>
> An Applicant's proposed HiBIS Service Area must be defined with sufficient specificity to enable a clear understanding by DCITA and the Applicant's potential Customers of the circumstances and locations in which the Applicant will provide a HiBIS Service.
>
> DCITA reserves the right to reject any application which, in its view, indicates the Applicant has defined the service area to target a particular

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155 Mr David Spence, *Committee Hansard*, 13 April 2005, p. 114.

156 Optus, *Submission* 12, p. 11.

157 DCITA, updated answer to Question on Notice 140, tabled 24 May 2005 at the Environment, Communications, Information Technology and the Art Legislation Committee *Budget Estimates*.

158 Optus claimed to have received 22% of the HiBIS fund at the ATUG conference in Canberra, 12 May 2005. See *Telecommunications in Rural Australia – Stimulating Competition for Real Future Proofing*, ATUG website, 22 June 2005, at: www.atug.com.au/atug2005Regprogram.cfm.

Customer group, rather than all Eligible Customers able to receive the service in a HiBIS Service Area.[159]

6.191 The Committee recognises that the HiBIS currently allows registered service providers to avoid developing infrastructure for broadband delivery, thereby limiting the number of Eligible Customers access to broadband. There is no obligation to provide a means for future customers to access broadband.

Broadband options

6.192 There are a number of options available to achieve equitable broadband accessibility, particularly in regional, rural and remote communities. The Committee has heard that broadband should become part of the USO, with the required extra funding coming from increased industry subsidies;[160] that the USO should remain as an STS provision, funded by Telstra and leaving the development of broadband to the telecommunications service providers;[161] and that the government should set a ten year national target for an optic fibre consumer access network roll-out, overseen by the ACMA.[162]

6.193 The Committee, however, favours the consideration of further developing the Higher Bandwidth Incentive Scheme (HiBIS), so that a service provider would receive suitable financial subsidies from the Government to develop broadband services in specified rural, regional and remote areas according to a scale that favours the development of broadband infrastructure over single satellite pickup. The Committee does not suggest that satellite services should not be subsidised at existing levels, but rather that financial incentives be provided for developing infrastructure which may benefit multiple users, where that is possible.

Recommendation 23

6.194 The Committee recommends that funding of the Higher Bandwidth Incentive Scheme (HiBIS) be broadened according to the following provider subsidy principles:

- **a higher subsidy for a broadband service that creates suitable and sufficient infrastructure for use by multiple consumers (taking into account immediate and future needs of consumers in an area), such as those using ADSL via cable or wireless; and**

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159 Higher Bandwidth Incentive Scheme (HiBIS), *Program Guidelines*, p. 45, 17 June 2005, at: http://www.dcita.gov.au/__data/assets/pdf_file/25005/HiBISGuidelinesU.pdf.

160 Mr Paul Budde, *Committee Hansard*, 13 April 2005, p. 47.

161 Optus, *Submission* 12, pp 4, 16.

162 Senate Environment, Communications, Information Technology and the Arts References Committee, *Report into Competition and Broadband Services*, August 2004, Recommendation 1.

- **the existing level of subsidy for a broadband service delivered to individual consumers via satellite where other means such as ADSL and CDMA can not be utilised.**

6.195 The Committee also considers that HiBIS subsidies should be sufficient to encourage potential broadband service providers to apply for registration in the specified areas, and costed so as to allow them to meet service obligations without undue financial and administrative burdens.

6.196 The scheme would rely on the development of realistic pricing regimes for use of networks so as to encourage broadband service providers to use cost-efficient means to deliver broadband to rural and remote communities. The Committee has previously recognised the need for the ACCC to investigate backhaul accessibility and costing arrangements for broadband carriers.[163]

Recommendation 24

6.197 The Committee recommends that the ACCC examine the availability of access to, and cost of, backhaul services for carriers building or proposing to build new broadband infrastructure in regional Australia.

6.198 The Committee recognises the difficulties experienced by smaller broadband service providers with fewer resources to apply for registration with DCITA, and notes the complex application requirements, as evidenced in the HiBIS Program Guidelines and Application for Registration.[164] The Committee considers that there appears to be scope for simplification of that application process.

Recommendation 25

6.199 The Committee recommends that the Government consider simplifying the HiBIS application requirements in order to give regional broadband service providers more realistic opportunities to apply.

6.200 Apart from the complexities of applying for HiBIS registration, the Committee heard evidence of delays in the processing of completed applications. For example, one small telecommunications provider in Townsville claimed that the ACA received its application for HiBIS registration in October but did not finally register the organisation until April the following year:

> We were the first in Queensland to come out with regional wireless broadband. We have been very restricted by the authorities. We have got

163 Senate Environment, Communications, Information Technology and the Arts References Committee, *Competition in Broadband Services*, August 2004, Recommendation 9.

164 Application for registration as a HiBIS provider, accessed on 24 June 2005, at: http://www.dcita.gov.au/__data/assets/word_doc/23253/HIGHER_BANDWIDTH_INCENTIVE_SCHEME.doc.

hundreds of thousands of dollars worth of capital equipment sitting idle, waiting for licences and approvals from ACA.[165]

Recommendation 26

6.201 The Committee recommends that the Department of Communications, Information Technology and the Arts streamline the processing of applications from broadband service providers for registration with the HiBIS.

6.202 The Committee recognises that the Digital Data Service (DDS) and Special Digital Data Service (SDDS), which delivers access to internet at around 19 kbps (non-broadband) through the normal telephony copper wire, do not meet the legitimate expectations of the Australian community. The broadening of the HiBIS as recommended by the Committee would mean that the DDS and SDDS would eventually be replaced by broadband services that would meet this expectation.

6.203 The Committee recognises the merit in local governments developing business schemes with the potential to deliver affordable broadband services to regional and remote areas, and supports efforts by local councils in developing business models for trial.[166]

Recommendation 27

6.204 The Committee recommends that the Government fund local governments to develop business models that focus on delivering affordable local broadband services to regional and remote Australians.

People with hearing and speech impairment

6.205 The Committee is concerned that hearing and speech impaired people do not have adequate access to telecommunications services. The Australian Communications Exchange (ACE), in arguing for a new definition of the Standard Telephone Service, argued that access to broadband would bring significant benefits for hearing and speech impaired people. While the Committee has not recommended that broadband be made part of the USO, improved access to broadband through the HiBIS scheme would significantly assist hearing and speech impaired people, providing that the service delivered the required minimum 384kbps upstream and downstream for sign language over video.[167]

6.206 The Committee has previously recommended that a disabilities equipment fund should be established,[168] and that consultation between representatives of people

165 Mr Noel O'Brien, IQ Connect Pty Ltd, *Committee Hansard*, 21April 2005, p. 72.

166 See, for example, Orana Regional Development Board, *Submission* 8, pp 6-8.

167 ACE, *Submission* 7, p. 2.

168 Senate Environment, Communications, Information Technology and the Arts References Committee*, The Australian Telecommunications Network,* 2004, Recommendation 14.

with disabilities and telecommunications carriers should be required to ensure that the new equipment will be available in conjunction with the new technologies.[169]

Recommendation 28

6.207 The Committee recommends that the Government provide funding to ensure that deaf and hearing and speech impaired people have equal access to a suitable broadband service through HiBIS and through an independent disabilities equipment program.

The Customer Service Guarantee

6.208 The Committee is concerned about the declining telephone repair performance figures in rural Australia, amounting to as much as five percent in recent years according to NFF statistics. The Committee notes that the Government has yet to fulfil the promise it made in 2003[170] to deliver the outcomes recommended by the Estens Report. As the NFF noted, basic telephone service fault and repair standards must be met before the Government can claim that services in rural, regional and remote areas have been improved.[171] As discussed in Chapter 2, the NFF disputes the Government's assessment of the status of implementation of several of the Estens Report recommendations.

Recommendation 29

6.209 The Committee recommends that the Government fulfil its promise to implement all 39 recommendations of the Estens Report. The Committee further recommends that an independent audit of the Government's implementation of the Estens Report recommendations be conducted prior to the introduction of legislation providing for the further sale of Telstra.

Consumer protection

6.210 The Committee remains steadfast in its call for the adoption of those strategies detailed in the ACA's *Consumer Driven Communications* (CDC) Final Report that better protect the rights of the consumer in the telecommunications industry, and supports the concept that telecommunications is primarily a service available to all Australians. In particular the Committee endorses Recommendation 2 in the CDC Report, which details proposed changes to paragraph 117(1)(i) of the Telecommunications Act. The Committee seeks to ensure that the consumer drives the telecommunications industry, and is disappointed that the ACA (now the ACMA) has not yet responded to these recommendations.

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169 Senate Environment, Communications, Information Technology and the Arts References Committee, *The Australian Telecommunications Network*, 2004, Recommendation 15.

170 NFF website, *News Release*, 16 June 2005, at: http://www.nff.org.au/pages/nr05/082.html.

171 NFF website, *News Release*, 16 June 2005, at: http://www.nff.org.au/pages/nr05/082.html.

Recommendation 30

6.211 The Committee recommends that the Australian Communications and Media Authority give immediate and urgent consideration to adopting the recommendations in the ACA research report *Consumer Driven Communications: Strategies for Better Representation* so that the rights of consumers are better protected, as previously recommended by the Committee.[172]

6.212 The Committee is concerned that there has been considerable delay in the development by ACIF of some of the codes of practice within the telecommunications industry. In particular, the Consumer Contracts Industry code, which was five years in the writing, has still another year to go before the ACMA can audit compliance. These delays have resulted, in some cases, with undesirable industry practices flourishing unimpeded, particularly those relating to unilateral alterations to the Standard Forms of Agreement (SFOAs) in section 481 of the Telecommunications Act.

Recommendation 31

6.213 The Committee recommends that Part 6 of the *Telecommunications Act 1997* be amended to require the ACMA to enforce the development of codes within set time-frames.

Complaint handling and code compliance

6.214 The Committee is concerned that many service providers not only fail to resolve complaints satisfactorily but also fail to refer their customers to the Telecommunications Industry Ombudsman (TIO).[173] The Committee notes that TIO figures show only between 11% and 16% of all complaints to the TIO are referred to the complaints handling scheme by the provider, despite the complaints code that obliges providers to refer customers to the TIO.[174]

6.215 An ACA representative told the Committee the ACA had sufficient power to deal with non-compliance,[175] but the Committee is concerned that codes of practice have not been enforced by the ACA, with only one instance of a direction being issued.[176] The growing number of overall complaints and the growing number of customer service complaints dealt with by the TIO[177] indicate a fall-off in providers'

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172 Senate Environment, Communications, Information Technology and the Arts References Committee, *A Lost Opportunity? Inquiry into the provisions of the Australian Communications and Media Authority Bill 2004 and related bills and matters,* March 2005, Recommendation 14.

173 Mr John Pinnock, *Committee Hansard*, 5 May 2005, p. 29.

174 Rule 7.6.1, *Complaint Handling Code*, ACIF C547:2004. See TIO, *Submission* 39, p. 3.

175 Mr Allan Horsley, *Committee Hansard*, 5 May 2005, p. 54.

176 Mr Allan Horsley, *Committee Hansard*, 5 May 2005, p. 54.

177 Mr John Pinnock, *Committee Hansard*, 5 May 2005, p. 29; TIO, *Submission* 39, p. 4.

performance in resolving customer complaints. The Committee believes that the new ACMA must do more to ensure compliance with industry codes of practice.

6.216 The Committee agrees with the CDC's recommendation, supported during this inquiry by the Communications Law Centre, that the Telecommunications Act should be amended to formalise monitoring of compliance with codes of practice.[178] A new section 120A should require reporting by suppliers/ industry associations on an annual basis and, where the ACMA considers that monitoring is not providing adequate or accurate data, monitoring by the ACMA.

Recommendation 32

6.217 The Committee recommends that the *Telecommunications Act 1997* be amended by inserting a new section 120A that requires annual reporting by suppliers or industry associations of compliance with industry codes and, where the ACMA considers that monitoring is not providing adequate or accurate data, monitoring by the ACMA.

6.218 The TIO's figures on escalation rates of cases referred to it show that almost 88% of customer complaints are not resolved between the customer and the provider after referral back to the provider by the TIO (level 1 complaint). The TIO then has to escalate the complaint to level 2, at cost to the provider. The TIO noted that since 2000, there had been 'a steady increase in the level 2 escalation rate' (that is, the percentage of cases not resolved at level 1). The rate was now 12% of all cases.[179]

6.219 The Committee believes that, to be effective, the complaints handling scheme should develop in step with changes in the telecommunications industry, should provide an adequate measure of protection to consumers irrespective of the services and the technologies used, and should allow consumers to bring a variety of complaints to the TIO in a way that increases the efficiency of complaints handling in the industry, reduces any overlap in jurisdiction and discourages consumers from forum shopping.[180]

6.220 The Committee has long held that the Telecommunications Industry Ombudsman should be able to offer consumer services not only in telecommunications but also in broader communications such as pay TV, particularly in light of converging technologies.[181] The Committee repeats its previous recommendation.

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178 CLC, *Submission* 23, p. 11.

179 TIO, *Submission* 39, p. 4.

180 TIO Ombudsman, *TIO Talks 33*, TIO website, 24 May 2005 at: http://www.tio.com.au/publications/TIO_talk_issues/33/33.2.htm.

181 Senate Environment, Communications, Information Technology and the Arts References Committee, *A Lost Opportunity? Inquiry into the provisions of the Australian Communications and Media Authority Bill 2004 and related bills and matters*, March 2005, Recommendation 17.

Recommendation 33

6.221 The Committee recommends that the *Telecommunications (Consumer Protection and Service Standards Act 1997* be amended in order to establish a single Communications Industry Ombudsman.

Low income consumers

6.222 As Mr Paul Budde stated, it must be remembered that telecommunications provide not only economic but enormous social benefits:

> It is important for our economy; it is important for our lifestyle; it is important for our kids; it is important for poor people and rich people and everybody else.[182]

6.223 The Committee considers that price controls provide significant protection for low income customers. The Committee notes that the Minister recently stated that the price control regime would be extended until 31 December 2005, pending the Government's consideration of broader telecommunications regulation issues.

6.224 As discussed in Chapter 5, the ACCC considered that Telstra's licence conditions which provide for measures such as LIMAC should be amended to require Telstra to comply with a low-income package and associated marketing plan specified by the Minister. The ACCC made a range of other recommendations aimed at ensuring that Telstra's low-income consumers are no worse off than its other users.[183] The Committee urges the Government to give the ACCC's recommendations serious and prompt consideration and to report publicly on which recommendations they will implement and which, if any, they will not support, and the reasons why.

6.225 Groups such as LIMAC and CTN argued that all telecommunications companies should have similar measures for those suffering financial hardship. Moreover, it is clear that, although certain measures have been put in place for fixed phones, there is concern about the impact on low income consumers of mobile phones as well as new technologies such as 3G. The Committee urges the Government and industry to put plans in place.

6.226 The Committee acknowledges that many consumers are forced to purchase packages or bundles from service providers that contain some services they do not wish to have, and that such consumers are only seeking to access local services at minimal rates. Accordingly the Committee considers that a basic residential package should be made available by all carriage service providers.

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182 Mr Paul Budde, *Committee Hansard*, 13 April 2005, p. 53.

183 ACCC, *Review of Telstra's price control arrangements*, February 2005, pp 113-117.

Recommendation 34

6.227 The Committee recommends that all carriage service providers make available a Basic Residential Package to households who want only a clear, cost-based package of local access services.

The Emergency Call Service

6.228 Finally, the Committee is concerned that the ACA has not yet considered the future development, funding, management and security of the Emergency Call Service (E000) in light of the rapidly emerging communications technologies, particularly VoIP.[184] The emergency call service, currently administered by Telstra, is facing difficulties.[185] The Committee notes that, under Part 8 of the TCPSS Act, the ACA (now ACMA) may, by written determination, impose emergency service requirements on all or any of the carriers, carriage service providers and emergency call persons.

6.229 The Committee believes that planning and developing the emergency service to take account of new technologies, particularly VoIP, is a matter of urgency. After Telstra is fully privatised, the federal Government should assume this responsibility.

Recommendation 35

6.230 The Committee recommends that the Government give urgent consideration to the recommendations of the National Emergency Communications Working Group, particularly in regard to new technologies such as VoIP.

Senator Andrew Bartlett
Chair

184 NECWG, *Submission* 3, p. i.

185 NECWG, *Submission* 3, p. 7.