Submission by

Australian Consumers' Association[1]

to

Senate Environment, Communications, Information Technology and the Arts Legislation Committee

Inquiry into the performance of the Australian telecommunications regulatory regime

2005[2]

Preface

The Australian Consumers' Association (ACA) is a not-for-profit, non-party-political organisation established in 1959 to provide consumers with information and advice on goods, services, health and personal finances, and to help maintain and enhance the quality of life for consumers. The ACA is funded primarily through subscriptions to its magazines, fee-for-service testing and related other expert services. Independent from government and industry, it lobbies and campaigns on behalf of consumers to advance their interests.

Introduction

The Australian Consumers' Association welcomes the Senate Inquiry into the performance of the Australian telecommunications regulatory regime, and the opportunity to contribute our views to it. It is obvious the impending completion of the privatisation process for Telstra will present a large challenge to that regime and that is the context we will use for our Submission. We will address the core question - is the regulatory regime sufficiently robust and operating sufficiently well for consumers to have confidence that when Telstra is fully in private hands telecommunications markets will not deteriorate? Unfortunately the market under the current settings for regulation and ownership is not delivering fully satisfactory outcomes. Regulators have had enormous difficulty curbing Telstra while it has been in majority Government ownership. There is little reason to believe circumstances will improve by virtue of the privatisation of Telstra. This raises considerable concerns that removing the role of Government as owner will also eliminate what lingering restraint there is over pure commercial pursuit of profitability in what is an essential service for all Australians.

The sale will place into private hands an enormously influential player with monopoly dimensions, inherited from natural monopoly aspects of infrastructure and from the legacy of being the national service provider. Unleashing a private monopoly into an uncertain regulatory environment seems to us a dubious public service. We share the widely expressed anxiety about the conflict that sits around the maximisation of the sale price and the protection of the interests of share purchasers, as opposed to creating regulatory certainty and restraints to protect the interests of consumers.[3] Restraining Telstra may diminish its sale value, but ensure that some of the value remains where it should; in the hands of consumers.

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[1] ACA File Reference 05F435/01; 6 April 2005; Contact Charles C. Britton (02) 95773290

[2] http://www.aph.gov.au/senate/committee/ecita_ctte/trr/tor.htm

[3] For examples see Attachment 3

Telecommunications is a vital national industry, one that delivers an essential and basic service to virtually every Australian. Part of the price of introducing a national competition policy in telecommunications and privatising the former monopoly incumbent is that we cannot also retain the notion of a national carrier, with the fiduciary discretion and fiscal latitude to support unprofitable activities in the national interest. We think that if the fuse of private fiduciary duty is lit on the powder keg of dominant market power, in the incendiary environment of indifferent levels of competition, significant consumer detriment will explode, harming all consumers, not just those in regional areas.

Market Structure

Competition still underdeveloped

The feedback from most commentators and regulators is that competition is immature at best; Telstra retains market dominance in most of its activities and near monopoly in perhaps those most essential. We think that the shape of the market at present is not encouraging in terms competition. The finding of the Productivity Commission in reviewing Telecommunications Competition Regulation[4] in 2001 that telecommunications market is not yet approaching competitive maturity is still relevant today. Subsequently to the substantive work of that Inquiry we saw high profile and lesser players exit the telecommunications market and substantial retrenchment by others. The ACCC work presented in the Price Caps Discussion Paper confirmed this immaturity of competition and highlights the vertical and horizontal integration of Telstra[5]. There are no signs of substantial new players entering the markets controlled by the price control regime. Sadly, the observation we conveyed to the ACCC about the state of the US telecommunications market by consumer advocates in the report "The Digital Divide Confronts the Telecommunications Act Of 1996 - The First Triennial Review February 1999" by the Consumer Federation of America and Consumers Union, remains as germane to the Australian market in 2004 as it was in 2000:

> It is time for policymakers to stop pretending that competition is right around the corner. It is unrealistic and possibly duplicitous to pooh-pooh today's price hikes as nothing more than a short-term setback or to blame the failure of competition and the absence of promised price reductions on regulators standing in the way. Policies must be adjusted to reflect the reality that the core telecommunications and TV services that are consumed in modest quantities by average consumers are and will be provided under monopolistic conditions for the foreseeable future.[6]

We note recent assessments of the state of competition from the ACCC. As recently as 1 April 2005 Ed Willett, Commissioner, indicated that "Our assessment is that competition for connections, line rentals and local, national long distance, international and fixed-to-mobile calls is patchy"[7] particularly for residential and

[4] http://www.pc.gov.au/inquiry/telecommunications/index.html

[5] http://www.accc.gov.au/content/item.phtml?itemId=599721&nodeId=file4248a165bea02&fn=Draft report—2004 review of Telstra price control arrangements (Nov 2004).rtf Pp17-18

[6] http://www.consumer.org/other/telecom4-0299.htm Pviii

[7] Promoting effective competition within the telecommunications sector 1st April 2005 Mr Ed Willett, Commissioner Service Providers Association Incorporated (SPAN) Sydney

small business customers. In submission to the PC Competition Policy Inquiry, the ACCC said "While retail price controls are already in place, the absence of effective competition across a range of retail services suggests that when considered as a group, prices generally still exceed cost."[8], indicating that Telstra currently earns a margin of over 9% across its fixed voice products.

In our view the policy aim in telecommunications should be to produce consumer power in an active telecommunications marketplace, combined with adequate consumer protection, both at street level from predatory market behaviour, and at the network level, from monopoly practices and pricing. Therefore the policy focus needs to be on consumer-oriented outcomes related to competition where it works (in urban retail environments) combined with management of market failure (rural Australia) and natural monopoly (the core network) when necessary. Government should create the optimal market conditions and then reap the best price that emerges in those circumstances. To do otherwise is to impose a form of sovereign risk or imposition on Australian consumers, whereby they contribute the elements of the sale price that evolve from the monopoly characteristics tolerated by the Government of the day and sold to private investors.

In summary the following steps, at a minimum, would move towards mitigating this eventuality:

1. Empower the ACCC adequately to address market power rapidly and effectively.
2. Create effective and permanent ring fencing or operational separation between Telstra wholesale and Telstra retail telecommunication activities.
3. Require Telstra to quit its activities in Pay-TV and ownership of the HFC cable.
4. Expansion of the consumer protection framework as recommended in the recent report, Consumer Driven Communications: Strategies For Better Representation.

Telstra a hugely dominant player with monopoly aspects

It continues to be our view that fully and finally privatising a vertically integrated and horizontally sprawling Telstra unreformed will not assist build genuine competitive pressures or deliver consumer benefit in the market, but *will* appreciably diminish the capacity of Government to bring the corporation to heel and *will* alter the balance of stakeholder interests pursued by the company.

We note the view expressed by the Productivity Commission (PC) in its draft report *Review of National Competition Policy Reforms* that as an issue of priority for nationally coordinated competition policy reform:

> *The Australian Government should widen the scheduled 2007 review of the telecommunications-specific, anti-competitive conduct regime to include consideration of the appropriateness of the structural configuration of Telstra. Consistent with NCP requirements, if the Government proceeds with the full privatisation of Telstra prior to that date, this review should also be brought*

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http://www.accc.gov.au/content/item.phtml?itemId=601493&nodeId=file42509404303 04&fn=20050401SPAN.pdf P3

[8] http://www.pc.gov.au/inquiry/ncp/subs/sub111.pdf P18

forward and its findings considered before the sale arrangements are put in place.[9]

While the terms of reference for this Inquiry cover substantially that canvas, with no disrespect to the Committee, it is not a substitute for Government undertaking a similar timely and appropriately resourced review as indicated by the PC.

Vertical depth

Telstra remains a huge, vertically integrated incumbent supplier that retains near monopoly control over essential and pivotal infrastructure. The dominant presence of Telstra in the market, particularly in terms of revenue and profit, based on ownership of the vital core network, means that economically persuasive offers to consumers are hard to find. In the view of the ACA, having such a dominant and pervasive player in the market continues to undermine competition and deny consumers best value in telecommunications.

In our opinion, the way to get the required economic depth to the telecommunications market is better access by competitors to Telstra's network. The access regime administered by the ACCC has failed to deliver this in a timely or affordable way. It is persuasive to hear from the Chair of the ACCC that "it has become increasingly clear to the Commission that there are limits on the extent to which effective and sustainable competition between Telstra and its competitors is possible under the current telecommunications regime."[10]

In prior submissions to this Committee, ACA has commented on delays in settling interconnect and access pricing, delays in settling arbitrations and disputes, protracted self regulatory processes and slow resolution of competition issues. The ACCC has recently played out a slow motion dispute with Telstra on wholesale broadband pricing. Apart from the specifics of the issue illustrated not only the ongoing perils of intertwined wholesale and retail operations, but also the difficulty of obtaining resolution of telecommunication competition matters in a timely manner. With regard to the wider position with regard to competitor access to local loop facilities for broadband purposes, ACCC Chairman has indicated that "there are disturbing signs that the undertaking process has become increasingly subject to regulatory game playing."[11]

More could and should be done. For example the ACCC should be provided with powers to require parties to cease and desist from anti-competitive conduct while a resolution is sought would increase incentives to resolve competition issues, while improving the sensitivity of the system to market entrants. There should be greater scope and requirement for regulators to step in and move the market processes along where it is evident that delay is threatening desirable outcomes from the point of view of competition or the public interest. The ACCC should be able to set industry wide

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[9] http://www.pc.gov.au/inquiry/ncp/draftreport/ncp.pdf

[10] Current state of telecommunications regulation 10th March 2005 Mr Graeme Samuel, Chairman Australian Telecommunications Users Group Sydney http://www.accc.gov.au/content/item.phtml?itemId=591603&nodeId=file422f9e9581125&fn=20050310%20ATUG.pdf P1

[11] http://www.accc.gov.au/content/item.phtml?itemId=591603&nodeId=file422f9e9581125&fn=20050310%20ATUG.pdf P9

reference prices rather than get bogged down in incessant arbitrations, which consume resources resolving essentially private disputes between parties that could perhaps be more usefully deployed directly pursuing public interest goals.

The Accounting Separation framework devised by the Government accepts that Telstra vertical integration is an issue. However it is disturbing, if not entirely unexpected, to hear from the ACCC as custodian of the regulatory operation and analysis of that framework say:

> We have repeatedly made clear our view that the current accounting separation regime has not been successful in giving us the kind of transparency we need in order to develop a satisfactory understanding of the way Telstra operates its businesses.[12]

The ACCC further states in submission to the PC:

> The ACCC's experience in administering the accounting separation arrangements suggests that the extent to which they facilitate the identification of anti-competitive behaviour is marginal at best. In most cases, investigations into allegedly anticompetitive conduct require the ACCC to collect very detailed, specific data which cannot be captured through periodic accounts reporting.[13]

Structural reform

In our view the notion of facilities based competition in anything but CBD and inter-CBD services has been shown to be a joke. The full service, vertically integrated telecommunications is no longer the preferred communications business model. In fact, the trend even for specific markets is separation of infrastructure holdings, often held as aggregated facilities, from service delivery components, between which competition proceeds. Exactly such an approach can be seen in the recent Telstra entry into 3G via Hutchinson's physical network infrastructure. This has profound implications for the notion of facilities-based competition. It positions Telstra squarely as a key holder of much critical infrastructure for which it would be uneconomic to develop substitutes.

The movement of the competition bottleneck in Pay TV from carriage to content and then on to a quasi-monopoly approved by the ACCC illustrates this. Facilities competition was robustly and visibly engaged (take a glance at the twin cables on power poles blighting so many suburbs). However the cable plant of both players has been substantially under-utilised, particularly if the failure to digitise is taken into account. However, with all this spare capacity, the industry beef was over access to content with which to build audiences, and was eventually settled in a set of arrangements that were reluctantly approved as the lesser of two evils. With the remote likelihood of a fully-fledged integrated facilities based competitor to Telstra, access to infrastructure becomes an even more critical issue.

We have argued that the essential solution is structural separation of Telstra Wholesale from Telstra Retail operations because if the normal logic of wholesale

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12 http://www.accc.gov.au/content/item.phtml?itemId=601493&nodeId=file4250940430304&fn=20050401SPAN.pdf P1

13 http://www.pc.gov.au/inquiry/ncp/subs/sub111.pdf P18-19

competition were allowed to operate, access would become less of a foreground issue. We have argued that this separation should be an equity separation, creating two separate companies. We can see the force of arguments that suggest the cost and complexity of 'unscrambling the omelette' may in fact be counter productive. However, while this may rebut equity based structural solution, it does not in our view negate the structural problems.

We are attracted to the development of effective 'operational separation' as a way forward. 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:

- 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
- Staff incentives linked exclusively to the relevant business unit

However, we are not persuaded that a voluntary approach such as the BT response to the challenge from UK regulator – Ofcom referenced by the Minister in a recent speech[14] will suffice. In our view it is essential to incorporate a legislative or regulatory obligation as part of the privatisation process. It may be useful or necessary to do this on an industry basis, and establish a ring-fencing requirement on any communications player engaged simultaneously in wholesale and retail activities in the same segment, subject perhaps to parameters of size or market share.

Price caps

Not withstanding the slightly frenzied response from Telstra to the largely unsurprising ACCC recommendations on price capping, ACA feels there is a definite and appropriate role for price control regulation is to promote competition, and in absence of this, to provide a responsive regulatory substitute. The social equity functions of the price control, while perhaps not in accord with absolute economic efficiency, have also proved an effective and immediate method of delivering outcomes for vulnerable consumers.

A core issue in the price-cap issue has been the rebalancing between fixed line rental or network access charges with variable call costs, especially the notion of cost reflectivity. The line-rental cost is one asserted by a provider with significant if not monopoly market power. It has been modelled into oblivion, and an essentially

[14] Senator the Hon Helen Coonan Minister for Communications, Information Technology and the Arts Address to the Australian Telecommunications Users Group Conference Sydney Wednesday 9 March 2005
http://www.minister.dcita.gov.au/media/speeches/address_to_the_australian_telecommunications_users_group_conference

political judgement eventually made about what the costs might be. Customer access network (CAN) pricing is not one that has or is likely to be challenged in a marketplace. It seems very unlikely that private capital will build a parallel CAN with the reach of that of Telstra[15] – and anything else is essentially cherry-picking. Thus price control is an important consumer oriented response to the structural problems discussed elsewhere in this Submission.

We have urged the retention of retail price controls on Telstra, at least until there has been a reform of Telstra such that the retail entities of Telstra compete on equal terms with all other access seekers. At this point, price controls should be instituted at a wholesale level. This approach would sustain competition in the absence of a number of competing vertically integrated players. Wholesale prices should continue to be the target of government mandated price controls to protect consumer interests in terms of structural competition deficits.

Price cap role in Fixed to Mobile calling

Mobile termination is a clear example of failed wholesale competition. Mobile Network Operators have a monopoly over call termination on their own network, and competitive pressures at the retail level do not constrain these termination charges. These prices are considerably higher than they should be, as acknowledged in ACCC work on the matter. Big business can sort the issue out commercially with the carriers, but small consumers have been essentially captive to what the companies want to charge, particularly where the consumer has no choice of what networks they traverse to place their call. However, despite its findings on inter-carrier charges the ACCC lacks tools to drive better retail pricing for consumers.

We are disappointed that the ACCC did not make a robust argument to Government for a co-ordinated strategy of matching retail price cap changes with the designated wholesale price path. Our view is that the Government must apply the ACCC wholesale price path specifically to retail fixed-to-mobile charges using the Telstra price cap regime. This would deliver consumer benefits from their inter-carrier determination, which otherwise threatens to deliver even greater benefit to incumbent fixed line suppliers. We also note the vigour with which the established mobile companies are defending the current anti-competitive status quo. All of these aspects demonstrate the need for strong, timely and effective regulatory intervention where telecommunications markets fail to operate effectively. Alan Kohler made a very good point when he suggested:

> The Government's sale of the rest of Telstra should be delayed for at least 12 months while all the frustrated recommendations of the Australian Competition and Consumer Commission - most importantly this week's new price cap regime that would result in a 4 per cent a year real cut in prices - are referred to someone independent. That person/commission should also look at the more basic question of whether it's a good idea to hive off the phone network into a separate infrastructure fund. It might well be a very good idea - for shareholders and the country.

[15] As the ACCC Discussion Paper on Price Caps 2004 acknowledged "Facilities-based entry requires significantly greater investment. In particular, it usually requires duplicating the local loop (or elements of it)" P24

Competitive chilling of new technologies

The power of Telstra is not exclusively tied to the vertical integration discussed above, although it is pervasive in influence. There is also the sheer weight of resources concentrated in Telstra. We are significantly concerned that Telstra has the means to game any regulatory regime or regulator successfully, and the critical commercial mass to co-opt or suffocate potential competition. There is periodically some conjuring with possible technological developments - broadband and wireless are variously referred to as possible 'get-out-of-jail' cards. However, policy makers must be careful to avoid the temptation to 'game the future', relying on the promises of technological developments yet to make their way in the marketplace. It is also important to focus on what is happening now and how powerful incumbents can use various processes to capture and subvert promising developments. This is a theme acknowledged by the Chairman of the ACCC, who stated recently:

> Bullish forecasts for competition resulting from new and emerging technologies must be approached with caution. While there certainly is potential for greater competition as a result of these technological advances, their long-term impact on the industry is yet to be demonstrated, and can easily be circumvented by Telstra.[17]

There are several examples where this chilling may be evident.

ISDN - a brief history lesson

It is important to bear in mind that we are not at the beginning of Australia's first broadband challenge, but rather the **second**. The first brave experiment with high speed digital access was ISDN, and we failed as a nation to make the best of this perfectly adequate method of computer connection for reasons that had far more to do with supporting existing market segments and profit centres than true economics or consumer benefits. It is worth reiterating an observation conveyed to the Department of Communications, the Arts, and Information Technology when it reviewed Price Controls on Telstra in 1999:

> The miniscule number of residential ISDN services is a strong indication that the high price to date has discouraged all but the most ardent Internet and data service consumers from obtaining a connection. It is of great concern given the flow-on effect this has on emerging social, cultural and business uses of the Internet.[18]

The pricing of ISDN meant the failure of Australia's first opportunity to facilitate consumer access to online technology. Recent contretemps with regard to wholesale pricing of broadband suggest that consumer pricing bears closer inspection, particularly in the light of speed and capacity restriction applied to apparently lower headline rates offered to consumer.

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[16] http://smh.com.au/news/Alan-Kohler/More-twists-than-a-tangled-cord/2005/04/01/1112302238306.html

[17] http://www.accc.gov.au/content/item.phtml?itemId=591603&nodeId=file422f9e9581125&fn=20050310%20ATUG.pdf P2

[18] Submission to Department of Communications, the Arts, and Information Technology Review of Price Controls on Telstra March 1999 P5

Voice over IP (VOIP[19]) using cable

There is a feeling abroad in the USA that cable-provided IP telephony could be the breakthrough that fulfils the vision of consumers with a true choice in local phone services. [20] One problem in Australia is that Telstra is the proud possessor of not only the major cable network in Australia, but also the traditional coper voice telephony wires. While Telstra is rolling out test VOIP services, and smaller providers are piggy backing on existing broadband services, there is no current serious infrastructure basis for VOIP competition unlike the USA. We fear this could mean delay in making this technological development with potential to dramatically lower prices available to Australian consumers.

ADSL competitor access

The ACCC noted recently that

> The potential for sabotage is especially pertinent in the broadband context in light of recent concerns raised by competitors contemplating the mass roll-out of ULLS/LSS based services.[21]

and canvassed a range of non-price based problems that may be confronted by competitors seeking to deliver DSL services to consumers on their own equipment in Telstra exchanges, such as:

- Not enough qualified staff to meet demand;
- Limits the number of migrations on a given day;
- Lack of access space and other facilities in exchanges;
- Protracted delays while the refurbishments and systems are designed;
- Longer time taken to supply and repair non-Telstra gear;
- Porting practices do not enable the seamless transition of a customer.

The conclusion is that it may be difficult to support the mass-market DSLAM deployment that is currently being contemplated by a number of service providers.

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[19] IP is a standards-based packet switched network protocol, initially adopted as the main network protocol for the Internet — hence the name Internet Protocol — but which can be used for the transport of not only data, but also voice and video across networks of all types. The use of IP to transport voice traffic is not a new concept but it is only now using IP to transport voice traffic is becoming commercially viable, and goes under the acronym VoIP. Using IP packets to transmit voice is much more efficient as there is no concept of dedicated point-to-point circuits. This should allow much cheaper voice services to consumers, as well as integration of voice services into other data application. However, key challenges remain in maintaining quality of service (QOS) and coping with the disruptive challenges the approach poses to traditional voice telephony regulation – such as price controls.

[20] http://seattlepi.nwsource.com/business/apbiz_story.asp?category=1310&slug=Phone%20Rates
Instead, two rival modes of placing calls have been keeping pressure on traditional phone companies to hold down prices: cell phones and the Internet-based phone services being introduced by all the major cable TV companies, independent players such as Vonage Holdings Co., and even AT&T.
Estimates vary, but millions of Americans use their cellular handsets as their primary or only phone service. In addition, tens of millions more of the nation's 175 million wireless subscribers use their mobile phones for long distance because they have national calling plans with unlimited off-peak minutes. Internet-based phone service, often called "VoIP" for voice over Internet Protocol, hit the mainstream over the past year with the introduction of service from AT&T, top cable companies and many small upstarts.

[21] http://www.accc.gov.au/content/item.phtml?itemId=601493&nodeId=file4250940430304&fn=20050401SPAN.pdf P5

Once again consumers will be the ones to miss out on the benefits of competition.

Content services on Mobile or Broadband

The Chairman of the ACCC has called attention to the potential for exclusive contracts to be anti-competitive, and that this is a risk should the exclusive acquisition of content rights in new and emerging markets like DSL broadband and 3G mobiles. These could potentially enable holders of such exclusive rights to shut out competition across a range of services these new networks can deliver including video material, data, extended voice services and hybrid services such as video calls. The ACCC indicates that it wants "to be sure that in an environment of new technology involving new competitive infrastructure, that a single dominant player doesn't have the capacity to stop that new competition at its birth."[22]

The capacity of a dominant player to stymie innovations can emerge from surprising quarters. It is useful that the regulator is vigilant, although concerns expressed above about the state of the regulatory apparatus in telecommunications do not necessarily inspire great confidence that such challenges will easily be met.

Horizontal reach

We have concerns about the competitive state of the Pay TV marketplace. We note recent reports that following the Foxtel-Optus Content Sharing Deal in 2002 "Optus subscriber numbers have since fallen by as much 100,000 - more than a third of its subscribers"[23] While this is being spun as a benefit for consumers, it is apparent that consumers have been unimpressed to date. For the dominant player to give permission and financial support to putative rival could scarcely be seen as the operation of an unfettered competitive market. The fact is that pay TV is limping along in Australia.

We have even greater concerns about the long-term peril that lies in the bundling of local telephone and broadband from the dominant telecommunications carrier, Telstra, with Pay TV from its part owned subsidiary Foxtel. This could reinforce market dominance in all directions. It plays to the concerns discussed above the potential chilling of VOIP and as a locus of content deals.

Further, in the inevitable capital shape of Telstra privatised into the hands of many small shareholders, the influence of major corporate shareholders in the Foxtel venture may come to have a disproportionate influence over the concerns of Telstra in general. This is unlikely to deliver consumer stakeholder benefit. It is also a concern in an environment where changes to media regulation are also in contemplation.

A key recommendation of the ACCC Report to Minister for Communications, Information Technology and the Arts, "Emerging Market Structures in the

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22 http://www.accc.gov.au/content/item.phtml?itemId=591603&nodeId=file422f9e9581125&fn=20050310%20ATUG.pdf P10

23 http://www.smh.com.au/news/Business/Optus-gets-Foxtel-digital-pay-TV/2005/04/07/1112815670127.html?oneclick=true

Communications Sector", which was rejected by the Minster of the day, but that in our view remains persuasive, was:

1. "The Commission recommends that the government introduce legislation requiring Telstra to:
   - divest the HFC network in full, and
   - divest its 50 per cent shareholding in Foxtel"

In our view the requirement that Telstra to 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. Given the need to create certainty for investors in the Telstra privatisation, our view is that this divestment should be expedited while Government is in controlling ownership of Telstra. An alternative would be to create a generalised divestment power for the ACCC as a tool to address excessive or abused market power.

An alternative future sees major telecommunications carriers introducing fast DSL over traditional phone lines, fast enough to allow video-on-demand services to the home. While this would offer competition to Foxtel, it would merely re-shuffle the deck chairs since it would reinforce reliance on Telstra's copper network, and make Telstra an even more direct player in the delivery of subscription video. Alan Kohler captured the difficulty well when he observed:

> Telstra is heading rapidly towards offering a broadband "triple play" (voice, internet and TV channels), at which point it will compete directly with Foxtel. Foxtel, meanwhile, should be doing the same thing - like all cable TV companies - but it can't because Telstra is blocking it.[24]

In this context the issues of operational separation canvassed above become intense since competitors will need access not just for voice, but to deliver the so-called "triple play" bundle of voice, data and video services. This would be a challenge not only to telecommunications competition regulation, but also to media ownership diversity rules. In our view media regulation should be extended to encompass Pay TV and broadband used to deliver equivalent services. It would also be useful to establish impose a test on the competitive outcomes from bundling before the Telstra privatisation is finalised.

Consumer Market Experience

The position of the ACA on the need for marketplace reform before the sale of Telstra flows from an analysis of the experience of consumers in the telecommunications marketplace, as detailed in our submission to the Committee's 2002 Inquiry into the Australian Telecommunications Network and Inquiry into the provisions of the Telstra (Transition to Full Private Ownership) Bill 2003. As we submitted previously, and stated above, in our opinion the primary issue at stake in managing change in the

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[24] http://smh.com.au/news/Alan-Kohler/More-twists-than-a-tangled-cord/2005/04/01/1112302238306.html

industry should be the outcome in the lives of consumers, not the result for investors or the price for taxpayers.

We reported our belief that there has been a serious deterioration of consumer trust in the telecommunications marketplace, which it would not be extreme to call a crisis of consumer confidence. The relevant analysis is provided in Attachment One. That analysis has been updated with reference to CHOICE work on mobile call plans. It is also worth noting that while we would like to have continued the analysis of the AComA figures[25], it is unfortunate that the Authority has chosen not to continue asking these questions in its annual surveys. Perhaps the answers were inconvenient?

The blame does not lie with consumers as the AComA tried to spin their findings, suggesting consumers are failing to use the opportunities supposedly there in the market. The fault lies in the regulation of the market and in way in which that market is structured. In the view of the ACA, the AComA has presided over the failure of the self regulatory scheme in telecommunications to deliver a comprehensive and effective scheme of consumer protections, while also providing a measure of the ongoing the impact of the structural problem of a market dominated by a vertically integrated and now horizontally sprawling corporation – Telstra.

It is certainly clear that the number of complaints to the Telecommunications Industry Ombudsman (TIO) on all aspects of the industry continue to rise. The 59,850 complaints investigated in 2003/04 were 7.8% more than the 55,515 complaints investigated last year.[26] The trend is not encouraging as the TIO reports receiving a total of 21,344 complaints in the September quarter 2004 – a 15.0% increase on the June quarter.[27] This is amid ongoing disquiet about industry complaints handling behaviour, which was reflected in the recommendation from the recent Consumer Driven Communications: Strategies For Better Representation[28] (CDC) Report:

> 48 The Minister direct the AComA to undertake a public inquiry into complaint handling procedures within the industry. This recommendation is supported by the huge concerns that have been raised in all forums about the difficulty involved in making a complaint about communications services.

If the TIO does not submit directly to the Committee, we would recommend the Committee take steps to ensure they hear the views of the Ombudsman on the rising tide of complaints and industry commitment to stemming that tide.

Further recommendations for reform found in the CDC Report include:

- Better mechanisms and triggers for intervention by the AComA
- More vigorous enforcement activity by the AComA
- A single Communications Industry Ombudsman (CIO)
- A single umbrella Consumer Protection Standard
- Greater consumer involvement and influence at all levels
- Updating the USO

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[25] Particularly in relation to the statement "I am confident that my interests as a consumer are being protected in today's competitive telecommunications environment."
[26] http://www.tio.com.au/publications/annual_reports/ar2004/annual_200404.htm
[27] http://www.tio.com.au/publications/TIO_talk_issues/32/32.4.htm
[28] http://internet.aca.gov.au/ACAINTER.3997752:STANDARD:969748898:pp=DIR2_2,pc=PC_1661

USO

The USO is a vital part of consumer protection, directly addressed in the terms of reference from the Committee. Indeed it is a major topic in its own right, and we have consistently called for Government to undertake a serious inquiry into how the USO can transition to the future as a framework couched in a technologically neutral way to deliver communication services to consumers, but one that can negotiate specific changes and developments in communications technology. Instead we are confronted with relatively sterile commercially driven debates about costing and allocation.

The Quantum of the USO

Determining the amount deemed to be the cost of the USO has been and probably always will be a political act. Modelling is captive of assumptions that embody the goals of those who drive the model. Simply providing the incumbent with the asserted cost of providing USO services presents obvious difficulties. Establishing the amount, essentially by a negative auction for what the rest of industry will put up with paying, does not have greater appeal. Trying to motivate a positive auction for the right to provide USO services has been a failure. We see the solution, at least conceptually, to address the USO issue as one of need rather than cost. That is the quantum of USO cost should be set with reference to the *need* for such services, tempered with the imperative for sustainability and persistence. This amount cannot be set by industry. It is inevitably a Government task, and hence will inevitability be political in nature. However that does not mean that the process of establishing the needs and compromises cannot be transparent, accessible and accountable. None of these are to be found in the current processes, which also fail to deliver certainty for industry players or consumers. In the current context it could be argued that the political process has determined a sustainable sum. From a practical perspective, the issue then is how to scale that sum into the future, and as a reasonable proxy our suggestion is that the USO amount should be indexed to growth total eligible industry revenue or CPI whichever is the higher.

What is the USO

It is important to note that there is an important non-geographic element to the USO. As the USO framework is forced to confront the changing nature of telecommunications and the very nature of the STS itself, these non-geographic features may well assert themselves as key components of the USO. It is critical that Australians with disabilities and socio-economic disadvantage gain equitable access to communications and to the benefits that a competitive telecommunications market can deliver. Therefore we consider disability access and social support programs should be independent of any single industry participant. Socio-economic equity of access and affordability should be addressed on an industry wide basis, rather than being contingent on the generosity, good citizenship or commercial calculus of individual firms. In both these circumstances there should be a benchmark of service provision, and if firms do not chose to deliver, they should be required to pay a USO contribution to support players that do.

We consider it useful to arrange levels of service engagement in a hierarchy - these are:

1. Universal availability
2. Universal connection

3. Universal service
4. Universal service standards
5. Universal quality of service and affordability

Each level supports the next. The Customer Service Guarantee parameters of connection time and fault repair times do not refer to actual quality of the telephone service delivered. In our view this will become an increasingly important part of defining the consumer experience of communication services. The focus of consumers is on the experience of the service delivered, which includes affordability, useability and quality of service as well as geographic accessibility.

The Standard Telephone Service (STS) fortuitously functions across all these levels, either by rules or by convention. However, as the face of telecommunications changes, such a fit cannot be assumed. It will become increasingly artificial to segment voice as the USO does. Consumers are growing indifferent to the means by which the service is delivered, and where they care it is usually for reasons of price rather than the mode of delivery.

While consumers focus on services, industry is conjuring with variable quality of service as a saleable component of consumer level communications services, including voice. This development will add an additional layer of complexity to debate about USO provision. There is already pressure to add performance requirements to best endeavour offerings like dial-up Internet and broadband. VOIP offers tuneable voice quality. There is the difficult task of defining the service levels and the parameters used to measure quality. There is the problem of assurance, which is consistent delivery of the promised quality or service level. From a USO perspective, a fundamental question is whether in an environment of differentiated service quality the service obligation applies solely to entry-level or minimum quality standards. Or would the USO supplier be required to be able to deliver a full range of quality offerings? These questions need considered answers from policy makers.

Universal Bit Service?

It is becoming increasingly clear that in the digital era the USO cannot be conveniently confined to a simple STS. The STS voice service will be one bit stream among many, and possibly not the most important bit stream. This submission is not the place for a lengthy exposition of the potential impact of digital convergence in communications. However it is essential that any policy review in this area must address the capacity of the policy framework to sustain and accommodate change. The USO does not have adequate capacity to do so. It is not sufficient for the USO simply to be stated in technologically neutral terms. The USO is actually under challenge by quite technologically specific developments.

If the USO fails as an effective mechanism into the future, what would an effective mechanism look like? Government should announce and commence a process to solve the question. One critical dimension is the shape of the USO in a fully private commercial industry. The other is the ongoing impact of technological change. The merger of the Australian Communications Authority (AComA) and the Australian Broadcasting Authority (ABA) into the ACMA points up the way lines are blurring between communications media as they dissolve into bits. When the means of delivering a voice bit, a video bit, a text bit or a data bit are the same, then the USO obligation will essentially mean access to bit carriage, and the framework must be capable of accommodating this change. The USO should not become just a minimal standard voice 'safety net'; it must continue to be a tool to ensure that all Australians are connected to national communications networks in ways relevant to contemporary social and commercial usage.

The Geographic Dimension

The ACA has consistently maintained that rural and regional telecommunications policy must find a horizon beyond the next round of privatisation (see Attachment Two). We regard it as an enduring necessity to ensure that consumers in regional areas can plug in to the communications advantages of today and the network necessities of tomorrow and the days that follow. In this regard we concur at a headline level with the conclusion of the Page Research Centre Report, which "does not reject the privatisation of Telstra providing two elements are put in place:

> 1) It leads to the achievement and maintenance of parity between metropolitan and non-metropolitan communities and that parity is guaranteed through a blend of regulation and competition; and
> 2) Measures are introduced to create greater competition in the telecommunications sector through regulation designed to address the monopolistic characteristics of Telstra's market position."[29]

The point of difference is perhaps on the matter of "parity". Such a state may well be a useful vision; however in our view interventions to assist regional areas to remain connected must be made on a sustainable basis as they try to meet a moving target. In the view of the ACA policymakers must recognise the constant risk, perhaps certainty, of market failure in some regional areas, and engage the necessity of Government stewardship, to ensure supply of services in the last resort. Australia requires a statutory body to oversee and in the final case supply telecommunications services to regional and rural consumers appropriately comparable to urban services on a sustainable basis. This requirement will become more urgent when Telstra is finally and fully privatised.

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29 http://www.page.org.au/downloads/PRC_Telecomms_Paper.pdf?PHPSESSID=eba3871df1d1d8d58f19238939df65f6 P33

Attachment One

Consumer Market Experience documented in CHOICE

Ongoing research efforts by the CHOICE team consistently confront difficulties in pinning down the industry and service providers on details of what is on offer, and this is a feature virtually every time CHOICE Magazine (published by the Australian Consumers' Association) has advised consumers on the changing industry.

It is probably not a coincidence that the most positive sounding comments are at the time the telecommunications boom was at its most rampant (1998 – 2000), and the telecommunications market seemed to be going somewhere. The ACA has been, and is, supportive of competition and consumer choice in telecommunications, hence the anticipatory tone about resolution of the difficulties in price comparison – unfortunately, complexity appears to have become a permanent and negative feature of the marketplace.

February 1993 "Restructuring of the telecommunications industry ... is taking place in stages, the first of which included restructuring Telstra and dismantling its monopoly on some telephone services. It means more choice for consumers and. initially at least, some confusion."[30]

September 1996 "OUR VERDICT – The pricing differences are small, and neither carrier is cheaper in all situations. You may think it's confusing – that's because it is! One of the things we'd like to see as competition grows in the telecommunications industry is simpler charging structures to make price comparison easier."[31]

September 1998 "The telecommunications industry was opened up to competition in July last year with high expectations of better service and cheaper prices. It's not an automatic improvement, though: competition means that if you really want to save money on phone bills, you need to shop around and take advantage of price changes and special deals. At the moment there are plenty of good deals available, with prices going down across the board."[32]

August 2000 Mobile phones: don't get caught in a trap "Confused by the ins and outs of mobile call plans? Want to know what it'll cost? How can you find out where you'll get coverage? Our guide looks at this and more." What follows is a 5-page guide to navigating the purchase of a mobile phone call plan, including the observation that "One reason buying a mobile phone plan is so complicated is that there can be several different companies involved ... or the same one could provide the network, service and billing."[33]

July 2001 "Some service providers seem to be making their plans as complicated as possible. If you consider all the features, specials, contract conditions and restrictions, it's very difficult and extremely time-consuming to compare deals. This

[30] CHOICE February 1993 P7
[31] CHOICE September 1996 P17
[32] CHOICE September 198 P22
[33] CHOICE August 2000 P14

lack of clarity contradicts everything consumers are told about competition giving them choice and better value for money."[34]

October 2002 "You can't trust the information provided by mobile phone customer service centres. Our anonymous caller received incorrect answers to very basic questions one third of the time: not an acceptable standard. Customer service operators also often failed to give our caller critical information about fees and call costs."[35]

May 2004 The guide to finding a good deal on a mobile plan has grown to 6 pages to assist consumers navigate the landscape of "hundreds of deals and packages out there".[36] Critically the comprehensive article is accompanied by a list of 8 additional factors the analysis could not accommodate, ranging across billing increments, credit expiry time, starter kits, discounts, international calls and roaming, MMS, handset instalments, and exit fees to current plans.

Ongoing research efforts by the CHOICE team consistently confront difficulties in pinning down the industry and service providers on details of what is on offer. It is driving a conclusion that perhaps the industry participants are not completely conversant with what they are putting into the marketplace – if so, what hope does an individual consumer have? The ACA has been, and is, supportive of competition and consumer choice in telecommunications, hence the anticipatory tone about resolution of the difficulties in many articles – unfortunately, complexity appears to have become a permanent and negative feature of the telecommunications marketplace.

Industry view agrees

The difficulties consumers have in the marketplace are also well understood by industry. In an industry survey by Deloittes, it was reported that:

> The respondents perceive that the general public does not really understand the products/services, technologies and choices available to them. When compared to the prior year, marginal improvements in the public understanding of technologies and choices were evident.[37]

The details can be seen in the 'No' response to the following questions about respondents' assessment of whether the general public:

Understands the products/services?	No 68%
Understands the technologies?	No 88%
Understands the choices?	No 80%

This is a damning assessment of the success of industry communication to consumers, by industry itself.

Evidence from the Regulator

This assessment is reflected in consumer surveys by the industry regulator, the Australian Communications Authority (AComA), as detailed in the following table. An analysis of the results from the Consumer Awareness and Information Needs Surveys conducted by the Australian Communications Authority in 2000, 2001 and

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[34] CHOICE July 2001 P20
[35] CHOICE October 2002 P8
[36] CHOICE May 2004 P18
[37] http://www.deloitte.com.au/downloads/telcosurvey_jan02.pdf P21

2002 paint a worsening picture of consumer confusion and distrust in the telecommunications marketplace. The Authority publishes the results each year, and makes a year on year comparison. We have arranged comparable responses over the full three-year period the surveys have been running, something the Authority has not done). This shows an alarming trend. All comparable indicators show a decline in consumer regard for the market. There is an explicit and progressive deterioration in consumer confidence (Ref 3)[38]. Consumers do remain engaged in the marketplace. Although not a growing number, most are still prepared to shop around (Ref 6). However, there is significant and growing difficulty in comparing prices and services (Ref 2) and many find unbiased purchasing information hard to get (Ref 7). Consumers are finding companies increasingly less responsive (Ref 1) and the inertia of keeping all services with one provider has a strong grip (Ref 5). The result is summarised a measure that has run only in 2001 and 2002, but shows that half of consumers are not confident that their interests as consumers are being protected in the telecommunications market (Ref 4).

Australian Communications Authority (AComA)
Consumer Awareness and Information Needs Survey 2000-2002

Attitudes about telecommunications issues - residential consumers				
	Per cent agreeing with the statement			
Issue	2000	2001	2002	Change
(Ref 1) Providers of telephone services today are more responsive to my needs than they were five (2000 three) years ago	73	71	63	-10
(Ref 2) I find it difficult to compare the prices and service features of different telephone companies	59	66	68	9
(Ref 3) I feel more confident about making a decision regarding telecommunications now than I would have five (2000 three) years ago	67	66	61	-6
(Ref 4) I am confident that my interests as a consumer are being protected in today's competitive telecommunications environment	n/a	55	50	-5
(Ref 5) I feel it is easier and less hassle to keep all my telecommunications services with one provider	78	80	82	4
(Ref 6) I would be happy to shop around and make use of multiple providers if it meant I got a better deal for my telecommunications services	63	62	62	-1
(Ref 7) It is hard to know where to go to get objective, unbiased information on different telecommunications costs and services	70	71	71	1

[38] Since the Statements are numbered differently in each Survey, and are not numbered in the AComA reports, we have assigned each statement a reference number (Ref n) in the Table included in the Submission. This is purely internal to this document and does not relate to any AComA scheme of reference.

Attachment Two
The enduring need for geographic USO assistance

It is an accepted wisdom of the telecommunications technological revolution that communications shrink distance, that access to the telephone and its cousin, the Internet based on data communications are bringing city and country into some sort of parity. There are those that see urban areas dissolving into some sort of digital matrix of virtual reality, where geography will be unimportant. Consequently where people work and live and play will become unimportant, since they are all to be intermediated by electronic exchanges over networks. In this vision people will be cocooned in virtual communities, tele-work from home or wherever they happen to be, and relax by the electronic interactive hearth that television is supposed to morph into.

This has been a seductive vision during the last decade. Billions of dollars have been spent on infrastructure (laying optical fibre, buying spectrum right for digital usage) and business experiments to prepare the ground for migration to this electronic future. The corollary of the end of the city is the end of the country. So policy has been bent to raise the infrastructure of regional areas, and deliver services at a quality similar to urban areas. No doubt a worthy endeavour, but it is contemplated to have an end point, that at which parity will be achieved. The thinking seems to be, once geography has been abolished, intervention to redress regional imbalance can cease. This thinking is reflected in the notion of privatising Telstra when service levels in the bush are sufficient.

An alternative view is that the accepted wisdom is wrong. The observation can be made that communications technology has evolved over the last century, and has been overwhelmingly associated with the process of urbanisation. The suggestion from students of economic geography and telecommunications is that communication is a complement rather than a substitute for personal communication. Evidence for this can surface in surprising places – recent research by Nokia into the future of what is hoped to be the next-big-thing for wireless, multi-media messaging services (MMS) was reported to suggest that 70% of person-to-person MMS messages generate a voice call in response[39].

Simple messages generate interaction. Interaction drives a need for face-to-face meetings to communicate complex information. This can be inferred from indicators such as the growth of business air travel in the same decade as the dot-com driven technological explosion took place. It can also be judged from various studies of the concentration of information servers and developers. These are shown as usually developing around certain established urban centres (but not all urban centres). When a new centre develops, it remains the case that while new, it is a concentration, and that information production and hosting are not evenly distributed, as the decay of geography argument would suggest it ought. An important impact of telecommunications development has been the increased inter-concentration information flow – city to city.

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[39] The Economist April 27 2002 P66

There is no doubt that telecommunications brings important benefits to remote and not-so-remote communities brought into contact with each other and the outside world. However, it seems to be the case that we overstate the 'tele' bit. While marvelling at the distance effects, we overlook the local effects of communication technology, probably because they are indeed under our noses and easy to take for granted. Consider for example the role of the mobile in the lives of young people. It allows them to flexibly arrange and rearrange schedules especially en route (micro-coordination), to give real-time updates of social events; to know where their peers are and to be accessible to them. The central dynamics of the local effects are that they often facilitate face-to-face meetings. These are important because people value them for intrinsic social reasons, but also because they communicate complex information more successfully and resolve ambiguity more speedily. They play a key role in developing trust (something organisations such as banks that eliminate face-to-face opportunities for their customers should note).

The more communication there is and the greater the potential for personal interaction, the greater the 'information density' of an environment can become in terms of the amount of information stored and communicated, and the number of interaction points available. This information density is intimately associated with geography because the most valuable communication tool remains in-person, and bandwidth remains expensive when consumed in large amounts, amounts that increase with distance. That means people favour an environment where there is the potential for the most local interactions. Communications technology helps build this density, and in that way builds further the advantages and necessity of concentration.

Therefore, policy that drives telecommunications as the solution to the problems of urban concentration and regional disadvantage misses a crucial point. Connectedness is essential, and it is indeed important to ensure there is active intervention to redress the effects of urban concentration and assist regional people and communities to participate in the developing network economy. However, the fallacy lies in the notion that this intervention is a once-off effort. Indeed it may be a constant game of catch-up as communications technology continues and consolidates the concentration at network centres. It will be an enduring necessity of increasing urgency to ensure that consumers in regional areas can plug in to the communications advantages of today and the network necessities of tomorrow and the days that follow. Technological options keep unfolding, starting in the CBDs and rolling with increasing sluggishness out to more decentralised locations. Policy needs to recognise the constant risk, perhaps certainty, of market failure in this domain, and to engage the necessity of Government stewardship, to ensure supply of services in the last resort, and to make sure regional Australia stays connected as the telecommunications revolution continues.

Attachment Three

Examples of commentary on Telstra sale conflicts

Why T3 might not be inevitable

Alan Wood Australian IT March 23, 2005

"A conflict of interest plagues the Government: does it opt for a good share price or good public policy?" [40]

More twists than a tangled cord

Alan Kohler Sydney Morning Herald April 2, 2005

"What an April Fool's joke it is that Telstra is regulated by a controlling shareholder that wants to sell. That shareholder will soon decide how much the company charges its customers and therefore how much profit it will make and how much it can be sold for. It is almost corrupt - the sort of shenanigans you might expect President-for-Life Saparmurat Niyazov of Turkmenistan to get up to. On top of that, Telstra competes ferociously with those who need to share its network. It also controls one of its main potential competitors, Foxtel, to prevent it competing. Conflicts upon conflicts upon conflicts."[41]

T3 – the next dotcom fiasco?

Paul Budde BuddeComm Newsletter 5/04/2005

"The state of the Australian telecommunications market has lately shown itself to be more akin to the conditions we read about in places like Russia and South America – where government corruption abounds, and where government policies are manipulated to ensure that they profit the government's finances. This is an environment that is unacceptable in the countries with which we normally feel more aligned. … The clear conflict of interest the government has in all of this is becoming so apparent that is starting to hurt."[42]

Foxtel picture fuzzy and far from pretty

Elizabeth Knight Sydney Morning Herald March 25, 2005

"The issue for Telstra is that its broadband service also competes with Optus and there is a crossover between the services provided by this pair. There are conflicts of interest aplenty in this space, which should have been expected when Foxtel and Optus undertook a content-sharing agreement three years ago. For Telstra chairman, Don McGauchie, these are all issues that need to be overcome before the sale of the Government's 50 per cent of Telstra."[43]

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[40] http://australianit.news.com.au/articles/0,7204,12628395%5E15306%5E%5Enbv%5E,00.html

[41] http://smh.com.au/news/Alan-Kohler/More-twists-than-a-tangled-cord/2005/04/01/1112302238306.html

[42] http://www.budde.com.au

[43] http://smh.com.au/news/Elizabeth-Knight/Foxtel-picture-fuzzy-and-far-from-pretty/2005/03/24/1111525290716.html