Australian Competition and Consumer Commission

REGULATORY DEVELOPMENTS IN THE NEW MILLENNIUM

Address by the Chairman to open the Regulation Stream

ATUG now2000 Conference

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It is a great pleasure to address the Year 2000 gathering of this conference, which brings together so many people involved in the telecommunications and related industries in this country. I congratulate the organisers on the program, and am pleased to participate in it.

I have been asked to look at regulatory developments in the new millennium. And after nearly three years of deregulation in the Australian telecommunications market, this is indeed a good time to look forward. The fact that this year will also see a review of the telecommunications-specific provisions of the *Trade Practices Act* means that the regulatory regime will be under continuing scrutiny as the year progresses.

Overview

It is very clear that the telecommunications industry in this country is experiencing major structural and technological change.

Competition itself is transforming the market.

In 1997, Australia had a protected duopoly in the fixed telephone market, and three players with statutory protection in the mobile market. The industry was dominated by a single, vertically-integrated incumbent with enormous market power.

Less than three years later, thirty seven licensed carriers are operating in the market, together with dozens of carriage service providers and hundreds of Internet service providers. Most Australians now have a choice of at least two telecommunications operators for their long distance, international and mobile calls, and competition is now emerging in local calls and data services as well.

Some areas of the market are, of course, more competitive than others, and there remain areas of the industry where ongoing regulation is vital.

However, where competitive activity has increased, consumers have benefited from lower prices. The Commission has cut headline interconnection rates for Telstra's fixed network from 4.6 cents to around 2 cents. Retail prices for most services have fallen substantially.

It is worth emphasising just how large some of those retail price falls have been. Commission data show that the average prices paid by consumers for long distance calls fell by nearly 44 per cent in the four years to June 1999. Average prices for international calls fell by up to 60 per cent over the same period. Telstra's untimed local call charge is now 22 cents, although residential line rentals have increased by $2.20 per month. More recently, we have seen some other operators lower their local call charges to as little as 15 cents, although with some conditions on eligibility.

Consumer benefits from such price changes were estimated conservatively in a recent report by the Australian Communications Authority at between $300 million and $400 million over each of the last three financial years.

Consumers have also benefited from new service packages and features, many of which combine services unimagined a decade ago.

However, it is also evident that some of more entrenched competition issues remain before us. We are still developing pricing rules for regulated services, and core competition issues such as adequate provisioning times and service quality remain.

Technological change is also transforming the industry. Together with the changing nature and extent of competition in the market, it will be one of the major determinants of regulatory directions in the new millennium.

However, before we look too much further forward, I propose to begin, instead, by looking back – at the way the regulatory regime operated as the market responded to the opportunities presented by open competition. That will then provide the right context for looking forward.

The Commission's role

The particular responsibilities given to the Commission in July 1997 related to the structure and conduct of the market and its participants.

The Commission's job was, of course, to ensure that competition in the Australian telecommunications market was *established* and *protected.*

We helped *establish* competition by *declaring access* to specific network services under Part XIC of the *Trade Practices Act*. This encouraged entry by removing the need for competitors to own infrastructure before they could offer services carried by that infrastructure. It also provided the mechanism for ensuring that any-to-any connectivity would be a reality.

The Commission initially declared a variety of voice and data-based services which were already being supplied by Telstra to Optus and Vodafone during the earlier duopoly period.

We subsequently declared additional data and transmission services, including ISDN, to allow more competition in new medium-bandwidth services important for data and Internet applications.

More recently we declared several local access-based services, including an unbundled local loop service to encourage competition in the markets for local voice services and broadband services, and a broadcast access service on cable networks.

It is worth pointing out that in markets which the Commission found to be reasonably competitive, such as the mobiles market, services were not declared. This was the case in global roaming and long distance mobile services. That is not to say that even in such

markets competition issues will not arise, as evidenced by the Commission's recent mandating of mobile number portability. Consumer sentiment in relation to the mobiles market is also that airtime charges are too high.

Of course, declarations only establish the *right* of an operator to access the facilities of another carrier. Frequently the *terms and conditions* of that access have also been the subject of Commission attention.

Access declarations and access pricing were, and will remain, critical to the emergence of competition in this industry. They ensure that non-distortionary build-buy decisions can be made by new entrants. The fact that we have seen both interconnection and new network construction in the post-deregulation period suggests that this process is working.

Our other role, of *protecting* competition, has been exercised through special arrangements to monitor and injunct anticompetitive behaviour under Part XIB of the *Trade Practices Act*, as well as under the standard competition provisions of the *Act.*

The Commission is also responsible for monitoring compliance with the price controls on Telstra, and monitoring prices more generally.

And, of course, *our more general competition functions* mean that we have also looked at mergers, acquisitions and consumer issues (including internet scams) when they affected telecommunications markets.

In exercising these responsibilities, the Commission has worked to develop processes to ensure that they are conducted fairly, transparently and with some certainty to industry participants.

We have developed pricing principles for established fixed line services provided by Telstra, and are reviewing the need for pricing principles for mobile and other services.

We have developed guidelines to explain our role and processes.

We have developed timelines for many of processes.

We have participated in industry self-regulatory arrangements, and made our staff available to talk to industry groups and forums.

We also contributed to the processes which resulted in amendments to some of our legislation last year, to improve the effectiveness of the anti-competitive conduct and arbitration provisions.

We have done all this in consultation with industry and with the other regulatory agencies.

I believe that the emerging competition we now see in many areas is evidence that the Commission has done its job well. The enormous investment going into the industry is proof that confidence in our processes is high.

I believe that the building blocks now in place have created a firm foundation for the further development of the market.

The changing industry landscape

The market is now, of course, a very different place than in July 1997.

I mentioned earlier the impact of competition in many areas and of new technologies and services.

Those developments are very visible. But even greater changes have been happening beneath the level apparent to consumers. We have seen an unprecedented expansion of infrastructure, fixed and wireless – particularly, but by no means exclusively, within and between cities. This has added enormously to the supply of bandwidth and to service options for consumers. In turn, a genuine wholesale market in bandwidth has been created, and complex intercarrier arrangements are emerging for originating and terminating calls.

The investment going into this industry and related industries, such as the Internet, is now a major stimulus to the economy and will establish a sound basis for income and employment growth well into the future.

Another important change is that associated with the phenomenon of convergence. I believe that the wisdom of having a general regulator deal with that industry is highlighted by this development. A general competition regulator has the ability to take a broad view of interrelated developments in many industry sectors.

Implications for the regulatory task

As a result of these changes, the nature of the regulatory task is changing. The competition issues are different in an environment in which competition is becoming more established in many areas of the market and in which some of the regulator's initial tasks (including decisions about which services will be regulated) have been completed or at least substantially advanced.

The focus is shifting at several levels.

Terms and conditions of access

In the first place, it is moving away from a focus on *ensuring access to essential infrastructure* to a focus on *ensuring that the terms and conditions of that access are reasonable.*

With a number of services already declared, with infrastructure continuing to expand, and with alternative technology platforms capable of offering data and voice services, new infrastructure bottlenecks are less likely to arise. Interconnection arrangements are, on the other hand, becoming more complex, with individual carriers now having to deal with more carriers than before in order to ensure any-to-any connectivity.

This has a couple of implications for us. It means, clearly, that decisions to regulate further services are likely to become a smaller part of our work. Indeed, the Commission is examining whether continuing regulation is appropriate for some services. We will be doing this where we judge that the service, or parts of it, are becoming fully competitive. We are about to commence a revocation inquiry in relation to transmission capacity on some intercity routes.

It also means that we are likely to see an increase in the number and complexity of intercarrier negotiations related to interconnection. The wholesale market is increasing in complexity and competitiveness. We would like to think that these negotiations will be conducted largely on a commercial basis, and will be encouraging this.

However, the number of disputes brought to the Commission under Part XIC of the *Act* for arbitration has been of some concern to us. We have received far more arbitrations than were ever envisaged when these provisions were introduced. Complex pricing arbitrations take time to complete, and raise resourcing issues for the Commission. We expect the negotiation/arbitration model to become more effective as competition increases in the market and as we finalise our core work on access pricing which will provide further guidance to industry on appropriate pricing benchmarks.

The Commission has been very active in ensuring that arbitrations are handled as speedily as possible. We have made a number of interim determinations and are close to final determinations in a number of arbitrations. We are also using a variety of dispute resolution options to speed the processes and to assist parties in resolving disputes themselves wherever possible.

Non-dominant networks and operators

A second shift of focus is from *incumbent and full service players* to *newer entrants and non-dominant networks.*

Competition has produced more operators in the market and, as a corollary, more participants in the Commission's processes.

Facilities-based competition also means that we are dealing with networks and services which have different technical features and different cost characteristics. We are developing cost and pricing models to reflect this. Just a few weeks ago, we held a Round Table on pricing principles for GSM networks, and will shortly be publishing the outcome of those deliberations.

Non-price competition

A third shift of focus is *from prices to non-price terms and conditions.*

Increasingly, *non-price terms and conditions* of access are influencing the ability of new entrants to offer services in competition with incumbent operators. Ensuring non-discriminatory access to operational support systems will be a priority for the Commission as the wholesale market develops further. While we are wary of regulatorily-imposed and overly prescriptive uniform access conditions, we will be working closely with the industry on initiatives such as the ACIF/SPAN Telecommunications Online Initiative (TOLI). The level of regulatory intervention in this area will be dependent upon the speed and success of industry initiatives.

Data and higher value services

A further shift in focus is from *voice services* to *data and higher value services.*

As competition has developed in the voice services market, prices have fallen substantially for most services, and are on a downward trend in all the others. This has delivered considerable benefits to consumers.

It also means that margins are being squeezed on traditional products, such as ordinary telephone calls. Service bundling is increasing as a marketing strategy, particularly cross-product bundling such as television and telephony, or telephony and Internet service. This is clearly a way for companies seeking to build high-value business to achieve a competitive edge, but also raises competition issues related to the ability of customers to purchase only part of the bundle. Bundling may also involve the sharing of costs across a number of services, and has implications for the way we regulate and monitor prices.

Acquisitions and mergers are another response to declining margins and growth in traditional services.

Merger and acquisition activity

Which brings me to a final example of a shift in focus - from *entry to the market* to *merger and acquisition activity within markets.*

It is clear that the potential benefits from mergers are increasing as the market globalises and as markets and technologies are converging. They enable firms to take advantage of changing economies of scope and scale and to leverage their existing services and customers in new markets.

Mergers between firms operating in essentially different markets have been a feature of recent times. Some of the mergers which have gained international attention in recent years have been of this type, typically between telecommunications or Internet firms and

broadcast or entertainment firms. Their longer term effects on the two markets which are subsequently straddled by the merged entity and, indeed, the longer term profitability of the entity, remain to be seen.

Cross-national mergers are also beginning to create firms with a global reach in telecommunications. New competition issues may well arise as a result of the operations of such firms across different jurisdictions. We will be watching those developments carefully.

The pressures underlying such developments appear to be of two types. Operators see the possibility of entering new markets by merging with existing players in those markets. So we have seen Telstra acquiring software development, data management and a range of ‘content’ companies, AAPT concluding negotiations with America Online (AOL), and a number of well-publicised acquisitions or joint ventures involving telecommunications players in Australia and other countries (including New Zealand). Some of our own newer operators are major operators in their own countries, and are clearly leveraging their experience and size in those countries in our own market. These moves attempt to exploit the economies of scope from operating simultaneously in both markets.

The second source of pressure for mergers is from attempts to gain economies of scale by amalgamating operations in the same market. The Ozemail merger, first proposed with Telstra, and then with eisa, was such an example. Last year’s proposed Optus-AAPT merger was another such example.

Let me reiterate the Commission’s approach to these issues.

Attempts to increase the efficiency and competitive capability of a company by seeking new markets or a larger share of the business in an existing market are not a problem for the Commission. Indeed, in a highly competitive environment, it is natural and desirable that firms should actively develop strategies for growth, as this fuels innovation and efficiency.

Only when a proposed merger is judged likely to result in a substantial lessening of competition, or prevent or hinder it, is it going to be a problem for us. This is more likely to be the case when the firms in question operate in the same market and hold substantial market shares or have the potential to develop them. This was the case in the proposed Optus-AAPT merger. It is much less likely to be the case when the firms operate in different markets, or when one of them is a small player. This was the case in the Telecom NZ-AAPT merger.

Conclusion

I would like to conclude by emphasising that the telecommunications industry in Australia remains an industry in transition. The regulatory developments of the next few years will reflect its changing needs and capabilities.

It was always the intention of the Government when it introduced the legislation which established the current regulatory framework that there would be a progression from prescriptive, industry-specific regulation to something much closer to the arrangements for industry more generally. Consequently, review provisions were built into the legislation. It is one of those provisions which will see the review, this year, of the telecommunications-specific provisions of the *Trade Practices Act*.

It is appropriate that, in a year of review, all the participants in the industry should be reassessing the type and extent of the regulatory regime needed to ensure that competition can develop and flourish in the interests of all Australians. I would not expect all participants to reach the same conclusions, but I hope they will all consider the issues carefully.

Competition is already ensuring, as I mentioned before, that in some areas some interventions can be reversed, and some price controls relaxed.

We have also seen co-regulatory and self-regulatory arrangements becoming well-established. We are seeing good outcomes from many of those processes, including in the area of industry codes. Others, including number portability and the unbundling of the local loop, are still in train. Their success or otherwise will become apparent shortly.

But while these developments have brought us a long way, there is still some way to go. And while the industry remains in transition, I think no-one would dispute that some regulatory intervention will be needed. Indeed, in network industries such as telecommunications, there is always likely to be a need for a robust access regime. The particular features of telecommunications, including the need for any-to-any connectivity, mean that specific safeguards are likely to remain an important component of the overall regulatory regime.

The issue is ultimately one of finding the right balance.

Consumers have benefited from significant price falls in existing services and from the introduction of new services and service packages as competition has taken root in this industry. The Commission is determined to ensure that such benefits will continue to be delivered.

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