

1 Thanks to Iain Gentle, Paralegal, Gilbert + Tobin for his assistance with this paper.

2 Productivity Commission 2001, *Telecommunications Competition Regulation*, Report No. 16, AusInfo, Canberra (released 21 December 2001).

3 See for example the Prime Minister, as reported in *The Australian*, commenting that Telstra's share price was currently too low for T3 to be viable (26 November 2002).

4 Schedule 2 of Part 2 of the Bill, which includes the removal of Subdivision F of Division 8, Part XIC of the TPA (Review of determinations). The transitional application of this reform was amended in the final version of the Bill. Merits review for final determinations has been maintained for access disputes notified prior to 26 September 2002.

5 New section 152CBA, which includes a new concept of a "special access undertaking".

6 New section 152BUAA and onwards.

7 New section 152AQB.

8 New section 152AR(4A).

9 New section 151AQB(1).

10 The timeframes in this table are measured from the time of commencement of the relevant sections. The Telecommunications Competition Bill has not yet received Royal Assent but is expected to do so before the end of 2002. Accordingly, "within 6 months" should be read as being by around end June 2003 and "within 12 months" should be read as being by around end 2003.

11 Section 152AQB(3).

12 Section 152DNA(9).

13 Item 15, Part 3 of Schedule 2, Telecommunications Competition Bill 2002.

14 Section 151AP(4).

15 Section 152CLA(4).

16 Section 151BUAAA, inserted as a

Senate amendment.

17 Senate Environment, Communication, Information Technology and the Arts Legislation Committee, referred on 25 September 2002.

18 Section 152CLA(4).

19 New sections 151BUAA, 151BUDB AND 151BUDC.

20 Media Release, Minister for Communications, *Telecommunications regime to be made more competitive*, 24 April 2002.

21 Media Release, Minister for Communications, *Government to boost telecommunications competition*, 24 September 2002. See also the Explanatory Memorandum to the Bill, pp 96-97.

22 Government amendments EC207, 3 December 2002, item 15.

23 New section 152AR(4A), with further clarification of ordering and provisioning permitted to be made through regulations.

24 Amended section 152EF(1).

25 See section 151AQB.

26 See amended section 151AQB.

27 See ECITA Committee Hansard, 22 October 2002 pp 48-49.

28 See ECITA Committee Hansard, 22 October 2002, p 48.

29 ECITA Report, p. 17.

30 See Angus Henderson et al, *Unscrambling the omelette and Unscrambling the omelette (Part 2): Implementing Effective Accounting Separation of Telstra*, Gilbert + Tobin, 7 May and 9 October 2002.

31 House of Representatives Standing Committee on Communications, Information Technology and the Arts, *Inquiry Into Telstra* (announced 11 December 2002).

32 Section 152AQB.

33 Section 152DO.

34 Section 152AT.

35 Section 152BU.

36 Section 152AL.

37 Section 152ALA.

38 Public inquiries are to be held under Part 25 *Telecommunications Act 1997*: Section 152ALA(4).

39 Section 152AO.

40 Section 152AO(1A).

41 Section 152CQ(1)(a) and (b).

42 Section 152CQ(1)(a) and (b) as amended.

43 Section 152CQ(1)(f).

44 Section 152CQ(1)(f) as amended.

45 Section 152EF(1).

46 Section 152AY(2).

47 Section 152EF(1) as amended.

48 Section 152DNA.

49 Section 152DNA(6) – (10).

50 Section 152AP.

51 Sections 152AP(3) and 152AP(4).

52 Section 152AI.

53 Section 152BJ as amended.

54 TPA s 152AS.

55 Section 152ASA

56 TPA s 152AR.

57 Section 152AR(4A).

58 Section 152AR(4B), (4C).

59 TPA s 151CJ.

60 TPA s 151AKA.

61 Sections 151AKA(9) and (10).

62 Section 151AQB as amended.

63 TPA s 151BU.

64 Section 151BUAA.

65 Section 151BUAB.

Telecommunications – Policy and Politics

David McCulloch comments on policy and political developments in telecommunications over the last 15 months.

INTRODUCTION

Much has happened in the telecommunications policy and political arena over the last year or so:

- The *Telecommunication Competition Bill 2002* ("The Bill") was passed by the Parliament in December 2002. The Bill implemented the Government's response to the Productivity Commission inquiry into Telecommunications Competition Regulation. While the Bill keeps the fundamentals of the telecommunications specific regime in place, it introduces incremental

changes in a number of areas, which are designed to improve the operation of the system. One of the measures in the Bill is the establishment of a framework to impose accounting separation on Telstra. This particular reform goes beyond the scope of the Productivity Commission inquiry.

- The Government made changes relaxing the price cap regime applying to Telstra. The reforms will allow Telstra to increase line rental charges over time to "cost", i.e. to over \$30 per month from current charges of about \$20. There are requirements for offsetting reductions in call costs. The ACCC and Telstra's competitors broadly endorsed these reforms,

which have positive implications for the competitive environment. The Opposition was unsuccessful in its attempts to have the Senate "disallow" the legislative instrument implementing the changes.

- The potential further sale of Telstra has dominated the political agenda, with an associated policy and political focus on rural communications. While the Government has now indicated its intention to defer the sale of Telstra, it is still likely to seek passage of implementing legislation in 2003.

The remainder of this article outlines these developments in further detail.

PRODUCTIVITY COMMISSION INQUIRY AND TELECOMMUNICATION COMPETITION BILL 2002

In mid-2000 the Productivity Commission ("PC") had been tasked to examine the telecommunications regulatory framework in the *Trade Practices Act 1974* ("TPA"), and recommend whether competition in telecommunications justified retention or relaxation of the telecommunications specific regime.

The two main sides of the debate on this issue comprise Telstra, on one side, arguing that competition is thriving and that the regime must be relaxed, with the rest of the industry, on the other, arguing the reverse.

In December 2001 the PC produced its 700 page final report containing 58 detailed recommendations. The PC came down on the side of recommending retention of the core aspects of the regulatory regime. In other words, it found that competition in telecommunications was sufficiently limited in certain areas to justify retention of a more stringent telecommunications specific regime.

The Government has already legislated¹ some recommendations from the PC's draft report released in March 2001. They were reasonably uncontentious reforms which sought to encourage commercial arrangements for access, and to expedite the ACCC arbitration process.

These reforms had occurred in the lead up to the December 2001 Federal election, in an environment where a number of Telstra's competitors were struggling financially, and the Opposition were accusing the Government of being "asleep at the wheel" in neglecting reforms to the regulatory regime.

By way of media release, the Government announced reforms in April 2002 in response to the final PC report². The response accepted the fundamental recommendation that the telecommunications specific provisions of the TPA needed to be retained. However, both implicitly and explicitly, the Government rejected many of the PC's recommendations. Many were simply ignored. In relation to merits review of ACCC arbitration decisions, the Government rejected the PC's finding, and indicated its intention to abolish review by the ACT.

Most surprising was the announcement that Telstra would be required to provide

accounting separation of its wholesale and retail operations. This was designed to provide greater transparency in the market, and to address concerns about the ease with which Telstra is able to discriminate in favour of its own retail operations, at the expense of services provided to its competitors.

What made this surprising was that accounting separation was not an issue dealt with or recommended by the PC. In fact, the PC had been specifically excluded from considering separation issues in its terms of reference.

Its inclusion in the package of measures, together with the balance of the Government's response, highlights the Government's desire to be seen to be acting to counter Telstra's perceived and/or actual unfair dominance. The Government's response can be seen in a number of contexts:

- the bursting of the "telco bubble" and the fact that many of Telstra's competitors were continuing to struggle, and – in the case of One. Tel – a collapse
- the continuing dominance of Telstra with 75% of industry revenues and 95% of profits; and
- the need to secure a solid regulatory environment to gain support for the further sale of Telstra

The uncertainty about the scope of the accounting separation announcement caused a negative reaction from financial markets, and a reportedly furious response from Telstra executives. This resulted in the Government releasing a statement indicating that it has no plans for *structural* separation of Telstra.³ This extreme negative reaction appeared to dissipate as the detail of what accounting separation would entail became clearer.

The Government introduced its reforms as the *Telecommunications Competition Bill 2002*. The Bill was referred to the Senate Environment, Communications, Information Technology & the Arts Committee for consideration. A variety of issues and suggestions for amendment were made by interested parties. There was debate over the strength of the accounting separation regime. Telstra's competitors recognised that the scheme as proposed would act as a moderate disincentive for Telstra to discriminate in favour of itself, and make such action easier to detect. However, there was a view that the regime was mild in scope, and significant strengthening of it was desirable. There was also debate, for

example, over the scope of the merits review exemption, and the relationship between ACCC arbitration and undertaking processes.

However, all affected parties – as well as all the political parties – recognised that the legislation broadly represented a step forward, and should therefore be enacted as quickly as possible. In the result therefore, there were no significant policy changes in the Bill during the Parliamentary process. The Bill was amended in a number of reasonably minor respects.

To conclude: while at the outset of the PC review, there was an expectation that it would result in major reforms and a potential watering down of the telecommunications specific arrangements, this has not been the outcome. The regime has essentially remained as is, and the reforms have been incremental in nature.

PRICE CAP REFORM

In April 2002 the Government announced changes that relaxed the price cap regime that would apply to Telstra from 1 July 2002.⁴

The essential elements of the reforms were:

- to allow Telstra to "rebalance", i.e. to increase line rental charges over time to cost, (at CPI plus 4% per annum, resulting in an increase to about \$32 per month from about \$20 currently charged). Under the previous regime, Telstra could not increase line rentals by more than CPI;
- to off-set the increase in line rental, a continuation of the requirement for Telstra to reduce prices across a "basket" of services;
- to remove of mobiles' services from the basket such that the basket now comprised STD, IDD, local and fixed to mobile calls. Mobiles were excluded on the basis that this market had become sufficiently competitive;
- to relax the annual required decrease of prices in the basket to CPI minus 4.5%;
- to continue the cap on local calls at 22c;
- the detailing of a low income package which, amongst other measures, ensured that pensioners and those on welfare cards were not worse off as a result of the changes. This compared

to the previous low usage rebate scheme that potentially advantaged high earners with holiday homes or whose home fixed line use was limited due to use of work mobiles.

The most politically controversial part of the reforms was allowing Telstra to "rebalance", and thus significantly increase line rental. This possibly explains why the Government chose to roll-over the existing price cap regime for another year in mid-2001, rather make these changes in the lead up to the December 2001 election.

Relaxation of the price cap was advocated by Telstra, its competitors, as well as – in principle – by the ACCC.

Telstra's ability to re-balance has benefits not just for Telstra, but for the competitive environment generally. This is because of the distortionary impact on the competitive market caused by the arrangements. The difference between what Telstra should charge for line rental, and what it actually charges as a result of the price cap regime, is known as the "access deficit". The ACCC requires other carriers to compensate Telstra for this access deficit. This is achieved by other carriers paying to Telstra an "access deficit contribution" (ADC) as a component of interconnect payments to Telstra. The ADC can be in the order of 30% of interconnect costs.

A sensitive component in the price caps regime is the amount by which Telstra is required to reduce its prices across the relevant basket of services. The amount of the annual reduction, after taking into account CPI, is known as the "x" factor. As indicated above, x in the case of the recent reforms is 4.5%.

Because Telstra can choose how to apply the reductions across the basket of services, its incentive is to cut prices most in more competitive markets, eg STD and IDD, and less so in less competitive markets such as local calls. If the x factor is too high, then there is the potential for Telstra to price below cost in these more competitive markets. This has the potential to drive competitors from the market, with a harmful impact on competition.

The Government's decision to impose an x factor of 4.5%, together with the exclusion of mobile calls from the basket, means that the new regime does not compel such sharp price reductions as the previous regime did. In other words, the Government has struck a somewhat different balance between imposing a degree of pricing discipline, and not

distorting the competitive environment, than under the previous regime.

The Government accepted the view of the ACCC, and arguments by mobile operators, that mobile services should be removed from the basket because the market was sufficiently competitive. Maintaining mobiles in the basket would have provided greater opportunity for Telstra to meet the price cap by reducing mobile prices. Such pricing is likely to have been driven by the market in any event, at the expense of reductions in less competitive services.

Perhaps the key component to gaining Government acceptance for the reforms was the development of the low income package that accompanied the reforms. Importantly, the Government and Telstra had worked with welfare groups in developing the package, and obtained their public endorsement to the total package of measures.

Notwithstanding support by welfare groups, following the Government's announcement in April 2002, the Opposition criticised the Government as failing to offer assistance for many whose line rental cost would increase to over \$30 per month. However, at this point the Opposition gave no indication of its intention to take action with respect to the increases.

As the Government's decision was not implemented via legislation, but by subordinate legislation, any Parliamentary consideration of the proposal would need to occur by way of a motion of disallowance of the regulation in either House.

In September 2002, the Opposition announced its intention to introduce a disallowance motion into the Senate.⁵ This was on the basis of Telstra's subsequent line rental increases which the Opposition claimed were not appropriately offset by call reductions. The Opposition were also critical of the exclusion of mobile services from the basket. There was speculation that Opposition were initiating the disallowance motion as part of their strategy in the lead up to the Cunningham by-election to be held on 19 October 2002.

A successful disallowance motion would have resulted in the previous regime being reinstated until 30 June 2003. Thereafter it would have been for the Government to implement a new regime. Senator Alston threatened that if the Opposition were successful, there might be no price cap regime in place from mid-2003.

In the result, the Democrats were persuaded that the new arrangements delivered a net benefit – approximately \$115 million per annum – to consumers. They opposed the disallowance motion, but in doing so extracted from Telstra a \$10 million expansion to the \$150 million low income package. As numbers in the Senate meant that the Democrats' support for the motion was essential, the disallowance motion failed, and the Government's reforms remain in place.

POTENTIAL SALE OF TELSTRA AND RURAL COMMUNICATIONS

Recent policy in telecommunications needs to be seen in light of the Government's goal of the full sale of Telstra.

The Government's stated position has been that it will "not proceed with any further sale of Telstra until it is fully satisfied that arrangements are in place to deliver adequate services to all Australians."⁶ In other words, the sale is not to proceed until rural, regional and remote communications services are – to use the Prime Minister's vernacular – "up to scratch".

Throughout 2002 telecommunications policy was focused on creating the environment to establish that non-metropolitan services were "up to scratch". There were also a raft of announcements and initiatives to create a "belts and braces" approach to consumer and competition regulation to enable the Government to assert that protections are in place, irrespective of the ownership status of Telstra.

In relation to the latter, initiatives throughout 2002 included:

- changes to the competition regulatory regime with the passage of the *Telecommunications Competition Bill 2002* including imposing an accounting separation regime on Telstra (see discussion above);
- establishment of a Network Reliability Framework (NRF) on Telstra;⁷
- announcement that the Customer Services Guarantee would continue to apply to all services providers (contrary to a recommendation of the *Besley Inquiry* that it should only apply to Telstra).⁸

In relation to rural communications, initiatives throughout 2002 included:

- continued implementation of the Government's \$163 million package of rural communications measures in response to the *Besley Inquiry*, including: the \$52 million National Communications Fund; \$50.5 million for improved mobile coverage, \$48 million Internet Assistance Program, and satellite handset subsidies;⁹
- roll-out of a satellite internet subsidy by Telstra, as part of the provision of untimed local calls in the most remote areas of the country ("the Extended Zones");¹⁰
- announcement of a \$187 million upgrade by Telstra to rural networks;¹¹
- announcement by Senator Alston of consideration of "future proofing" options for telecommunications services;¹²
- The Rural Telecommunications Inquiry (*Estens Inquiry*) – a three month inquiry into current and future rural telecommunications services that reported in November 2002. The report made generally positive findings about the state and future of rural telecommunications, and made detailed recommendations. The Government is expected to consider and respond to those recommendations in February 2003.¹³

For most of 2002 – at least beneath the public statements about rural services being "up to scratch" – the sale of Telstra seemed a key priority for the Government to progress as quickly as possible.

There were two key hurdles, though. First, gaining the agreement of the National Party, parts of which remained implacably opposed to the further sale. Second, was the need for Senate approval. Given the seemingly firm commitment of the Democrats and the Greens to oppose any further sale, approval would require the agreement of all of the four remaining other minor party/independent Senators, namely Senator Meg Less (Independent and former Democrat), Senator Len Harris (One Nation), Senator Shayne Murphy (Independent and former ALP), Senator Brian Harradine (Independent).

As 2002 progressed, the prospect of gaining support of all four Senators seemed increasingly remote. The Report of the *Estens Inquiry* in November 2002, whilst finding improvements in services, made a number of recommendations requiring specific response and action by

the Government. Until that was well in train, it was unlikely that that National Party would accept that services were "up to scratch". At the same time, the Telstra share price continued to languish.

It was in that context that in late November 2002 the Government indicated its intention to defer the sale of Telstra beyond 2003. It justified this on the basis that the Government was unlikely to obtain the proper return from a sale in the near term, given the Telstra share price.

The Government gave signals, however, that Cabinet would still proceed to consider the introduction of legislation authorising the sale in the short term, and the Government would seek the passage of that legislation. The Government would then be free to determine the timing of the actual sale following passage of the legislation.

Should legislation be introduced in 2003 the fact that the Government has put off the actual sale means that the temperature of the public and political debate may be lower, and the stakes not as high for the Government. If the legislation is rejected by the Senate, it has the potential to create a double dissolution trigger.

Labor's continued and strident opposition to the further sale of Telstra has been a key differentiating point for the Opposition. The Shadow Minister for Communications, Lindsay Tanner, broadened the Telstra debate from the Opposition perspective by issuing a discussion paper in May 2002 "Reforming Telstra" which examined Telstra's structure, and options for separation of Telstra. Separation (beyond the accounting separation framework contained in the Bill discussed above) was opposed by the Government.

It was curious then that later in the year (December 2002), Senator Alston commissioned an inquiry by the House of Representatives Standing Committee on Communications Information Technology and the Arts into the very topic of structural separation. The Committee was asked to examine the impact of structurally separating Telstra's core network from its core businesses, and reducing the Commonwealth's current shareholding in Telstra's non-network businesses.

It seems that the Minister's strategy was an attempt to embarrass or "tease" the Opposition by giving it the platform to raise the issue, on the basis that the inquiry would not illicit a groundswell of opinion in favour of structural separation, and that the Committee would

ultimately oppose structural separation.

It was originally planned that the inquiry would last through most of 2003. This was a risky strategy given the Government's hope to introduce sale legislation as soon as possible. The two would potentially cut across each other. The Government seemed to subsequently recognise this in truncating the inquiry and requiring it to report in March 2003.

1 *Trade Practices Act Amendment (Telecommunications) Bill 2001*.

2 Media Release, Senator Richard Alston, Minister for Communications, Information Technology & the Arts, "Telecommunications Regime to be Made More Competitive", 24 April 2002.

3 Media Release, Senator Richard Alston, Minister for Communications, Information Technology & the Arts, "No Government Plans for Telstra Structural Separation", 22 April 2002.

4 Media Release, Senator Richard Alston, Minister for Communications, Information Technology & the Arts, "Consumers to Benefit From Telstra Price Caps", 24 April 2002.

5 Media Release, Lindsay Tanner, Shadow Minister for Communications, "Labor Moves to Stop Telstra Price Grab", 17 September 2002.

6 The Howard Government Telecommunications Policy Statement, November 2001.

7 Media Release, Senator Richard Alston, Minister for Communications, Information Technology & the Arts, "Groundbreaking Network Reliability Framework", 16 July 2002.

8 Media Release, Senator Richard Alston, Minister for Communications, Information Technology & the Arts, "Telephone Service Guarantees for all Australians", 27 July 2002.

9 See, e.g. Media Release, Senator Richard Alston, Minister for Communications, Information Technology & the Arts, "Federal Government Satellite Handset Subsidy Plus Progress Report on TSI initiatives", 21 May 2002.

10 See e.g. Media Release, Senator Richard Alston, Minister for Communications, Information Technology & the Arts, "2-way Satellite Internet Offer for Remote Areas", 28 June 2002.

11 Media Release, Senator Richard Alston, Minister for Communications, Information Technology & the Arts, "Telstra Network Upgrade Funding a Bonus for Rural Australia", 1 July 2002.

12 Media Release, Senator Richard Alston, Minister for Communications, Information Technology & the Arts, "Future-Proofing of Telecommunications Services in Regional Australia", 12 July 2002.

13 See e.g. Media Release, Senator Richard Alston, Minister for Communications, Information Technology & the Arts, "Report of the Regional Telecommunications Inquiry", 13 November 2002.

The views expressed in this article are those of the author and not necessarily those of Optus.

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