

Submission by  
**Australian Consumers' Association**  
to  
**House of Representatives Standing Committee on  
Communications, Information Technology and the Arts  
Inquiry into the Structure of Telstra<sup>1</sup>**

## **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 (ACA) welcomes the Inquiry into the structure of Telstra, and the opportunity to contribute our views to it. We see the calling of the Inquiry as recognition of the importance of questions about how Telstra affects the structure and function of the telecommunications marketplace in Australia. These questions are worthy of serious discussion, and we do have concerns whether the short timetable for formulation, delivery and consideration of submissions will be sufficient for that work to take place.

### ***Outcome focussed analysis***

The position of the ACA on the structural reform of Telstra flows from an analysis of the experience of consumers in the telecommunications marketplace (detailed below in the section entitled *Consumer Market Experience*). The important issue in managing reform of the industry is the outcome in the lives of consumers. We believe 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. We see structural impediments to competition delivering the kinds of benefits to consumers that might have been expected when the telecommunications market was de-regulated (detailed below in the section entitled *Competition Not Delivering*). It is the view of the ACA that the dominance of the market by Telstra, 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. Our perspective is that if greater economic depth existed in the competition, there would be scope for complexity and consumer confusion to be squeezed out more effectively by market forces.

### ***Ownership a tool***

We consider that the direction of regulation and access direction has contributed to rather than ameliorated to this frustration of market forces. The way to deliver outcomes for consumers is to create market forces that will foster genuine

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<sup>1</sup> ACA File Ref 020405/1

competition. We feel this would best be achieved using ownership as a tool. Thus we advocate an equity separation of Telstra, one entity providing wholesale access to the network, the other (or others) providing retail services to consumers in competition with other providers. Such a restructuring would then harness competition where it can work (in the retail environment) but recognise and regulate the monopolistic tendencies in network provision. In our view, such a reform, far from devaluing Telstra could add value, by focussing business entities on competencies such as customer service (retail) and engineering excellence (network). It is useful to observe the infrastructure separation initiatives of mobile network providers, such that capital intensive networks are equity separated from retail service provision, exactly the model suggested for Telstra.

### ***Privatisation not the issue***

It is important to make the point that while the question of reforming Telstra in terms of such an equity separation often arises in the context of privatisation debates (which is not surprising since both ideas relate to changes in ownership), it is not inextricably joined to that debate. In our view, the current situation has emerged under full and partial government ownership of Telstra. It would be entirely feasible to undertake an equity separation as suggested and retain both portions in the current ownership ratio. Equally, both portions could be privatised, and many of the benefits of the separation would be achieved. That point made, it is our policy that the national network is a natural monopoly, and should remain in majority Government hands for the foreseeable future. Equally, we have major concerns that fully and finally privatising a vertically integrated and horizontally sprawling Telstra would not assist build genuine competitive pressures in the market or deliver better consumer outcomes. In our view, privatisation would present an opportunity to cement the benefits of separation by placing Telstra retail businesses into private ownership in the context of reforms to the self-regulatory regime. In this way the imperatives of ownership could be harnessed to deliver superior consumer outcomes.

## **Consumer Market Experience**

### ***Prices have been controlled***

An important question is just how much benefit consumers derive from telecommunications competition. There have been price drops in Australia since deregulation, although it is alarming to read analysis of CPI figures that shows "partly because of the collapse of One.Tel and other discounting tyros, the price of telephone calls has risen more than 4 percent over the past year"<sup>2</sup>. It is important to bear in mind that there has been an unsung hero in the story of lower prices – the Government mandated price cap regime on Telstra that has mandated reductions in prices for services baskets with minus CPI plus an x-factor. Therefore a critical market driver has been Government intervention. In our view wholesale price controls and caps (in the context of controlling a natural monopoly) should be substituted for the retail regime. This presupposes an environment where Telstra retail, separate from the network provider, would be subject to more genuine competitive market pressure.

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<sup>2</sup> "Strange but true-prices can go down" Ross Gittins Sydney Morning Herald 6-Nov-2002 P17

### **Complexity a major issue**

Complexity is itself a problem for consumers. Even were Australia to have a superbly self-regulated, competitive telecommunications market, if the average consumer finds it impossible to understand or navigate the offerings, then the market cannot be said to meeting their needs. Complexity is a key consumer trust warning and it has been a feature of the telecommunications marketplace in Australia since the inception of competition. The persistence of this complexity can be tracked through the commentary in CHOICE Magazine (published by the Australian Consumers' Association) virtually every time it has advised consumers on the changing industry.

**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."<sup>3</sup>

**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."<sup>4</sup>

**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."<sup>5</sup>

**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."<sup>6</sup>

**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 lack of clarity contradicts everything consumers are told about competition giving them choice and better value for money."<sup>7</sup>

**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

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<sup>3</sup> CHOICE February 1993 P7

<sup>4</sup> CHOICE September 1996 P17

<sup>5</sup> CHOICE September 198 P22

<sup>6</sup> CHOICE August 2000 P14

<sup>7</sup> CHOICE July 2001 P20

operators also often failed to give our caller critical information about fees and call costs.”<sup>8</sup>

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? It is probably not a coincidence that the most positive sounding comments are at the time the telco 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, the complexity appears to have become a permanent and negative feature of the marketplace.

### ***Industry view agrees***

The difficulties consumers have in the marketplace are also well understood by industry. In an industry survey by Deloitte’s, 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.<sup>9</sup>

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.

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<sup>8</sup> CHOICE October 2002 P8

<sup>9</sup> [http://www.deloitte.com.au/downloads/telcosurvey\\_jan02.pdf](http://www.deloitte.com.au/downloads/telcosurvey_jan02.pdf) P21

<b>Australian Communications Authority (ACoMA)</b>				
<b>Consumer Awareness and Information Needs Survey 2000-2002</b>				
Attitudes about telecommunications issues - residential consumers				
Issue <sup>10</sup>	Per cent agreeing with the statement			
	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

Analysis of the results from Consumer Awareness and Information Needs Surveys conducted by the Australian Communications Authority in 2000, 2001 and 2002 paints 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). 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).

<sup>10</sup> 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). This is purely internal to this document and does not relate to any ACoMA scheme of reference.

### ***A crisis of consumer confidence***

We believe it would not be extreme to call this serious deterioration of consumer trust in the telecommunications marketplace a crisis of consumer confidence. The Authority in the 2002 report recognises the trend “towards less confidence and greater confusion among the populations of residential and small business respondents”, but draws what we feel is a flawed conclusion that this suggests “a growing need for assistance in using the competitive telecommunications market to their advantage.”<sup>11</sup> The blame does not lie with consumers for 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 is presiding 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.

### **Competition Not Delivering**

Unfortunately, effective competition has not emerged across the whole telecommunications landscape of Australia. That telecommunications are insufficiently competitive was confirmed in the Productivity Commission Inquiry Report into Telecommunications Competition Regulation released in 2001. This was consistent with the view we expressed in our submission to their Inquiry. Subsequently to the substantive work of that Inquiry we have seen high profile and lesser players exit the telecommunications market and substantial retrenchment by others. There are no signs of new players entering the market. These developments are coupled with the global capital drought for telecommunications and the maturation of markets such as mobiles and dial-up Internet access.

### ***The future of Telstra***

Telstra remains a huge, vertically integrated incumbent supplier that retains near monopoly control over essential and pivotal infrastructure. The key consumer area that is not being contested is the local loop. In the estimation of the ACA the restraining hand of competition has a particularly faint influence in the local call market, although other telecommunications markets have far from robust competition. In our view a critical issue is how to engineer the future of Telstra, since this has profound relevance for future consumer outcomes in telecommunications. It must happen in a sensible way that recognises financial, commercial and political complexities, but that delivers real benefits for consumers in the street. It must maximise the opportunities for competitive markets and minimise bottlenecks and choke points, wasteful capital expenditure and consumer abuse in the marketplace, such as unfriendly contracts and selling practices. In our opinion, the aim 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. There should be a policy focus on consumer-oriented outcomes related to competition where it works (in urban retail environments) and management of market failure (rural Australia) and natural monopoly (the core network) when necessary.

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<sup>11</sup> <http://www.aca.gov.au/publications/reports/awareness/report2002.htm#attitudes> P15

### ***Contesting not competing***

In view of Australian Consumers' Association, what we have in the Australian telecommunications marketplace is the appearance, rather than the substantial reality, of competition. We have companies contesting vigorously - advertising, marketing, selling in shops and on the streets, and concocting ever more complex confections of product and service bundling. The only thing missing is clear, unambiguous customer value from the plethora of choice. We are certainly getting the negative effects of a hotly contested marketplace as demonstrated in the analysis of the consumer experience above. The Telecommunications Industry Ombudsman is kept busy with a constant flow of complaints as phone companies and ISPs constantly explore the boundaries of acceptable behaviour towards consumers. We have even have the spectacular collapse of entrepreneurial participant one.Tel, which over stretched in its efforts to build market share and customer numbers without reference to return on investment.

### ***One effective player***

While there is a froth of competitive behaviour in the market place, the bulk of the profit in the industry is earned by one company. Telstra, the former monopoly incumbent is still dominant player in many telecommunications markets. Telstra occupies about 75 per cent of the market, but earns over 90 per cent of the industry's profits.<sup>12, 13</sup> Much of the traffic handled by the new entrant companies must at some time pass through the Telstra Customer Access Network, typically on the last mile journey into the home. This extensive copper wiring system is too expensive for another player to duplicate. This is 'call termination'. If you want to talk to someone by phone, chances are, whomever you choose as carrier for long-distance, mobile, or international components of the call, Telstra will clip the coupon somewhere in transit. Having such a dominant and all pervasive player in the market in the view of the ACA continues to undermine competition. In the shallow, contesting market, consumers confront market forces that conspire to increase complexity, giving rise to what some analysts have dubbed the 'confusopoly'.

## **Structural Reform Required**

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. There have undoubtedly been issues with the speed, certainty and efficiency of the access regime that has been at the core of the push to break Telstra dominance of the access networks and to encourage competition. However, far from the program of competition development in telecommunications being sufficiently advanced for such regulation to be wound back, it would seem that the experiment has been advanced sufficiently only to diagnose what would make the idea work better.

### ***Access delayed is access denied***

The chief evil in the operation of the system is delay, coupled with failure of access seekers to gain commercially viable inter-connect rates. Delay in settling interconnect and access pricing, delay in settling arbitrations and disputes, protracted self regulatory processes and slow resolution of competition issues have bedevilled the

<sup>12</sup> Reforming Telstra Lindsay Tanner P 2 <http://www.lindsaytanner.com/Reforming%20Telstra1.htm>

<sup>13</sup> <http://www3.optus.com.au/content/1,1463,124,00.html>

regime generally. Overall the impression is that delay favours the incumbent. Therefore measures that improve the processes and increase the incentives for timely settlement of issues, in a framework that does not discriminate against the usually smaller and weaker access seekers and preserves the interests of consumers would provide greater certainty for business and contribute to the more speedy generation of competition inspired benefits for consumers.

Some recent steps have been taken by Government to extend the operation of the access regime but ACA feels Australia may have reached the end of what can be accomplished by extending and enlarging the regulatory apparatus in telecommunications. The Productivity Commission report highlighted regulatory risk and information overload. There are concerns about a possible failure by industry to invest. There is the problem of actually thinking up workable regulatory imitative that might make a difference. These difficulties primarily arise as a consequence of trying to manage access to the infrastructure of a huge, vertically integrated incumbent supplier that retains near monopoly control over essential and pivotal infrastructure. We argue the essential solution is structural separation of Telstra Wholesale from Telstra Retail operations. However this is precisely the topic that was proscribed to the Commission by the Terms of Reference for the Inquiry. If the normal logic of wholesale competition were allowed to operate, access would become less of a foreground issue.

### ***Long Term Interests of End Users***

Where ACA did not concur with the Productivity Commission in their review of Telecommunications Competition Regulation was their view that the Long Term Interests of End users test (LTIE) should be abolished and substituted with a plain public interest test. Consumer protection in the contesting market has been inadequate – we are concerned that it will be more severely tested in the immediate future as the budgetary strings are pulled tight and companies concentrate on reaping real commercial value from each consumer. Established telecommunications players are examining their businesses for opportunities to extract cash from consumers sooner rather than later. In Australia this is combined with an apparent ebbing of competition as high profile and lesser players exit the telecommunications market and others undertake substantial retrenchment. One would hope that in a competitive market this would revolve round a strategy to service customers so well they would happily stay around and perhaps part with a small premium. However, in a market suffering from stunted competitive pressures, the approach may well be more draconian. Sophisticated telecommunications have become a basic necessity of everyday life. But the adequate provision of such services to large areas of the population may not consistent with a dominant integrated corporation focussed on the bottom line.

### ***Equity separation to foster retail competition***

In the opinion of the ACA, what is needed is to split equity in Telstra into separately owned portions, one of which has custody of the critical core network. This network is currently in our view a natural monopoly, and should remain in Government hands for the foreseeable future. However, we would not endorse a policy that might purport to stop the development of competitors to this network. Were competitive pressures to emerge to confront the Government owned network, our opinion is that these should be encouraged and the consequences played out. However, we don't see signs



of this scenario being imminent – alternative networks to date have been essentially complementary to the existing core network rather than substituting for it. Most of the investment in telecommunications over the last decade has been CBD-centric, with little viable competition in the suburbs, let alone in the regions. When the retail components of Telstra compete on equal terms for access to the core network with other companies, we might see real, sustainable competition deliver telecommunications benefits to Australian consumers.