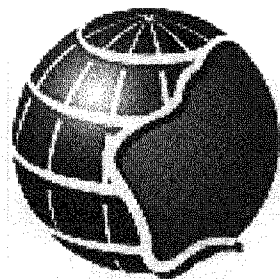


**Submission to House of Representatives
Standing Committee on Communications,
Information Technology and the Arts**

Inquiry into Structure of Telstra

January 2003



**Government of
Western
Australia**

INTRODUCTION

Western Australia has sparsely settled regional areas, widely separated towns, and limited physical access to business services outside major centres. Under these conditions, access to adequate telecommunications services is critical to the economic and social health and development of regional areas. The advances in information technology and the spread of Internet based communication and e-commerce are placing ever greater pressure on ageing infrastructure, much of which was only designed for limited voice telephony and not for the high-speed data interchange now demanded by the information age.

The essential requirements for telecommunications in Western Australia are therefore:

- universal and affordable access to reliable telecommunications infrastructure with the capacity for high-speed information exchange, both electronic data and voice; and
- affordable provision of sophisticated telecommunications services to allow regional residents to fully participate in the benefits arising from the advances in online technology, including communications and e-commerce.

Any policies and decisions, including the structure of Telstra and the Commonwealth's ownership of either infrastructure (network) or service (non-network) elements, should be developed with the aim of ultimately achieving these outcomes.

The current inquiry appears to have started from a position considering vertical structural separation of Telstra. Vertical separation, and reduction of Commonwealth ownership of telecommunications services, may well be a viable option. However, the issue is multi-faceted and the timeframe and scope of this inquiry is inadequate to make such a judgement. A more productive starting point would have been to begin with a clearly defined vision for telecommunications and the level of service required for all Australians. Strategies could then be designed, including the optimal structure and ownership for Telstra, best suited to achieving the vision.

Notwithstanding these deficiencies there are clearly some critical issues to be considered.

THE ROLE OF COMPETITION

In densely settled areas the competitive provision of infrastructure is sometimes viable. However, in most of Western Australia, telecommunications infrastructure is not only a natural monopoly, but the thinness of the market means that its provision is unlikely to be commercially profitable.

This is exacerbated by the age and inadequacy (or complete absence) of existing telecommunications infrastructure in many regional, rural and remote areas. Ageing infrastructure (installed, in some cases, over fifty years ago), was simply not designed for the demands now being placed upon it. New cable and wireless technology can deliver the required standard of service, but the cost of providing this new infrastructure, particularly to rural and remote residents, is often prohibitive. This argument applies not only in many cases to the "trunk" connections, it is critical with respect to the "last mile" of connection to a user's residence or business.

These factors place telecommunications infrastructure in regional, rural and remote Western Australia into the category of a utility that must be provided by Government, because the private sector will have no commercial incentive to do so. Government provision may be direct, or through subsidies or contracts to private sector providers.

There is potential for competition and multiple market participants in telecommunications service provision, certainly for niche services. Where such competition in service provision has occurred, customers have seen improvements in service quality and choice of products, and reductions in price.

A limiting factor in the competitive provision of telecommunications services is the availability and price of access to the essential infrastructure for competing service providers and their customers.

KEY ISSUES OF VERTICAL SEPARATION

Vertical separation of natural monopoly infrastructure from service provision functions facilitates and, some claim, is essential for effective competition in service provision markets. If the entity that controls the infrastructure is also a major player in the service market, it has the incentive to provide access to its own service arm on more attractive and competitive conditions than it provides access to entities that compete with its service arm.

There are a variety of options for separation, including accounting separation, managerial separation, corporate separation and full separation. In addition to vertical separation, there is also potential for horizontal separation – geographical or functional. Each option potentially varies in its impact on the matters under inquiry, such as efficient provision of services, ability to provide a full array of services, investment in infrastructure, regulatory regime and shareholder value. The restriction of this study to a specific vertically separated model seems premature.

KEY CONSIDERATIONS FOR STRUCTURAL SEPARATION

The following points are considered critical:

- The point-to-point infrastructure (Public Switched Telecommunications Network) should be retained fully in government hands.
- This government entity would be responsible for ensuring the provision of appropriate infrastructure to all Australians consistent with the standards of the time.
- Access to the infrastructure would be made available on an equitable basis to carriers for resale and provision of services to the ultimate end-user.
- Other than interoperability and access standards, there should be no restriction on the ability of carriers to build infrastructure.

COMMENTS ON THE TERMS OF REFERENCE

Efficient provision of services to end-users, including businesses and residential customers in regional, rural and remote Australia

Separation should not impede the efficient provision of services to end-users, provided the infrastructure provider is sufficiently informed of user needs and funded to provide and maintain infrastructure to appropriate standards. There are numerous tools available to the Government to ensure that the infrastructure provider operates efficiently, and market forces will dictate efficiency in service provision by carriers.

By providing equal access to the infrastructure network, telecommunications retailers will be competing on an even footing. (The Australian Competition and Consumer Commission (ACCC) would continue to provide oversight over competition to ensure this occurs.) This should mean a more efficient provision of services in areas where there is a business case to do so.

Service providers may be more interested in providing innovative solutions in regional areas – such as wireless broadband – if they can assure themselves of access to the overall network at prices on a par with their competitors.

Market forces will not address the needs of businesses and residential customers in much of rural and remote Australia. There is more chance that customers will be adequately served in these non-profitable areas if the government undertakes its responsibilities directly than if this is left to a company required to account to its shareholders for the size of its profits.

There will still be ongoing need for the strengthening and updating of Universal Service Obligations (USO) and Customer Service Guarantees (CSG) and the oversight by the Australian Communications Authority (ACA).

Telstra Country Wide has been very successful in reflecting and acting upon the needs of those living and working in regional, rural and remote Australia. This level of service must be maintained.

Telstra's ability to continue to provide a full array of telecommunications and advanced data services

A vertically separated model with a publicly owned telecommunications infrastructure network (TIN) and telecommunications retail sales organisation (TR) would not prevent a full array of telecommunications and advanced data services from being provided. Separation would not remove all of TR's market advantage, as it would retain the assets of the experience, accrued knowledge and skills of its people. As the largest market incumbent, TR would continue to have considerable influence on the market, and the economies of scale to be able to provide a wide range of services.

The retail organisation would have at least the same ability to provide services as any other provider against which they would be competing. Some synergy between infrastructure and service provision may be lost, especially in matching infrastructure investment with expected business benefits through the provision of new services. In a separated model, this matching would need to occur by contractual negotiation rather than management fiat.

Continued oversight by the ACA and powerful consumer groups such as the Australian Telecommunications Users' Group (ATUG), along with market forces, should ensure that the needs of most consumers are met, whether by TR or other providers.

Ongoing investment in new network infrastructure

Data transmission demands will increase with increasingly sophisticated online technology and services. While improving infrastructure technology can increase the data-carrying capacity of some existing equipment, the need for investment in new and upgraded infrastructure is likely to be ongoing.

This investment would be primarily the responsibility of the government-owned infrastructure agency (TIN), although there would be no regulatory restriction on other carriers or new infrastructure providers investing in additional infrastructure or paying for upgrades where they see a commercial justification. Regulation may be required to ensure the right to connect to TIN's infrastructure, and standards of interoperability and interconnectivity must apply, as they do now.

In denser markets, TIN would need to be permitted to set its prices to ensure that it could maintain and upgrade network infrastructure as required to ensure appropriate standards of capacity and reliability. Where the market could not support pricing at this level (particularly in regional, rural and remote areas), TIN's access revenue would almost certainly need to be supplemented by Government funding.

The Commonwealth needs to retain responsibility for telecommunications infrastructure provision since it has the telecommunications revenue raising capacity and can ensure that national standards are maintained to maximise equity of access and interconnectivity.

The wider telecommunications industry

Most of the industry would welcome vertical separation of Telstra, and this could eliminate much of the criticism against Telstra playing unfairly as both a wholesaler and retailer of services. Separation will not eliminate all complaints against the infrastructure provider by service providers. Service providers are likely to constantly challenge pricing, capacity, availability and investment levels by the infrastructure provider. The access regime, and the way it is applied and regulated, will be critical to the telecommunications service market.

Equitable and competitive access to infrastructure should stimulate competition, bringing benefits to those players providing better quality service and innovative solutions to end-users.

The telecommunications regulatory regime

As has been discussed, in most parts of Western Australia, the provision of telecommunications infrastructure is a natural monopoly, and the issue of equitable and affordable access must be addressed. To avoid abuse of monopoly power, including the extraction of monopoly rents, access to essential telecommunications infrastructure needs to be regulated, regardless of structure. However, a regulatory access regime for a vertically integrated provider needs to pay particular attention to the issue of equitable treatment of third party access-seekers compared with the treatment of the infrastructure provider's own service provision arm.

Given the essential nature of telecommunications services in the economy and for the community generally, some form of regulation to ensure adequate service provision will continue to be required, regardless of whether separation of infrastructure and services occurs. This is especially the case where market failure can be expected such as in rural and remote areas.

There would still need to be strong enforcement of updated Universal Service Obligations and Customer Service Guarantees to ensure that these were meeting community expectations as these develop over time with the introduction of new technologies. The ACA would retain an important role in the regulatory framework.

Telstra's shareholder value and its shareholders

Clearly, the dismantling of Telstra will have considerable potential impact on the value of shares held by investors. Allocation and valuation of assets will be critical, as will the rights of existing shareholders.

The Commonwealth Budget

The Commonwealth Government remains responsible for telecommunications in Australia and hence will need to make appropriate allocations in its Budget for telecommunications investment and projects on an ongoing basis, where such investment is required over the revenue earned by the infrastructure provider.

The Commonwealth will need to fund the provision of services in regional, rural and remote areas, where normal market forces are inadequate to ensure appropriate levels of service for residents and businesses.

CONCLUSION

The key issues for telecommunications in Western Australia are:

- the availability of adequate telecommunications infrastructure, capable of delivering modern communication and information sharing services, to all Australians,
- affordable and reliable access to that infrastructure for all Australians, using the service provider of their choice, and
- the upgrading of inadequate infrastructure.

It is essential that the Government and the industry address these issues as a matter of priority. Discussion of a specific structural model other than in the context of a strategic vision and plan for ensuring these outcomes is unlikely to be productive.

The Commonwealth is strongly urged to develop, in consultation with other tiers of Government, business, the community and the telecommunications industry, a clear and forward-looking vision for telecommunications in Australia. The goal should be universal and affordable access to telecommunications at a level that allows Australians to benefit from the rapidly evolving communications and online service technologies. This is essential for Australia to be competitive in the global knowledge economy, and for Australians to continue to be in the vanguard of the information age.

National strategies, for implementation by both the Government and the industry, need to be developed to progress the vision. These will include, but can not be limited to, the optimal structure and ownership of Telstra.

Contacts

Sheryl Siekierka
Policy, Planning and Coordination
Department of Industry and Resources
2 Havelock Street
WEST PERTH WA 6005

Phone: (08) 9222 5677
Fax: (08) 9222 5460
Email: shsi@indtech.wa.gov.au

Dan Scherr
Policy, Planning and Coordination
Department of Industry and Resources
2 Havelock Street
WEST PERTH WA 6005

Phone: (08) 9222 5675
Fax: (08) 9222 5460
E-mail: dasc@indtech.wa.gov.au