Consistency in regulation

It is critical that governments unite to continue energy reform. At present, some States are starting to diverge from the original goals of the Hilmer Report, or are using different methods to achieve these goals. This has the potential to create barriers to interstate trade in the future.

We are conscious of the costs to industry of dealing with multiple regulators and have been trying to ameliorate this administratively.

Competition in the retail market

The introduction of full-scale contestability across all customer classes offers many new opportunities for gas retailers, but also many new challenges.

The arrival of competition will create pressure for incumbents to maintain market share and a balanced customer portfolio. In this newly competitive environment there may be temptations to engage in restrictive trade practices or unfair trading activities.

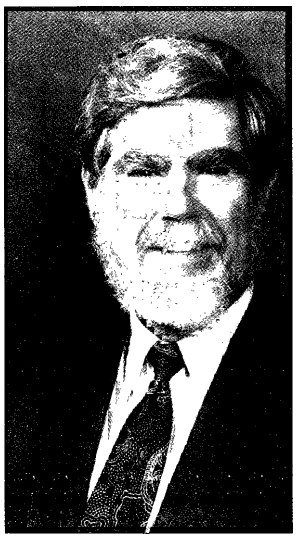
Though the Commission regulates gas transmission pipelines under the code, conduct at the retail end of the market is covered by the Trade Practices Act. Companies must be mindful that anti-competitive or anti-consumer practices can stall the benefits of reform and, importantly, may constitute a breach of the law.

Conclusion

In general, while there have been some positive efficiency gains from the implementation of gas reform to date, they have not been as significant as in electricity or telecommunications. The slow pace of reform and a less competitive supply sector are the key reasons for this.

It is my view that, unfortunately, the reform process appears to be losing momentum and Australia risks losing its place and could quickly fall behind other industrialised countries; therefore forfeiting opportunities to grow and prosper.

Telecommunications



The following are summaries of two talks given by Commissioner Rod Shogren on telecommunications regulation and issues. The first was to the Communications Research Forum 2000 on 5 October 2000 and the second to the SPAN–ATUG Industry Forum on 6 December 2000.

Regulatory issues

Australia is one of a number of countries currently re-examining its regulatory arrangements for telecommunications. All are seeking to ask whether telecommunications-specific competition regulation is still required and, if so, of what sort and in what form.

Subsidiary questions include who should be regulated — all carriers in a particular market, or just those meeting certain criteria — and who should do the regulating.

The review currently being conducted by the Productivity Commission is limited to competition and related provisions of the overall regulatory scheme. (Other countries have embarked on more comprehensive reviews.) However, other aspects of the regulatory regime affecting competition are also being reviewed or are undergoing change. These include the price control arrangements for Telstra and a new legislative framework for the provision of services under the Universal Service Obligation.

Productivity Commission origin of the current regulation

Until the early 1990s the government sought to directly regulate the telecommunications industry. But this reduced efficiency, incentives to innovate and access to capital.

The current regulation for open competition was introduced in 1997. Provisions introduced for the telecommunications industries included a telecommunications access regime under part XIC of the Trade Practices Act and anti-competitive conduct provisions under part XIB. Strong arguments have been presented to the Productivity Commission for and against retention of the current regime. Many tensions reflect fundamental differences in objectives and perceptions, whereas others result from disagreements on facts.

Concerns about the current regime

Groups critical of aspects of the current regime have made a number of claims to the Productivity Commission. I would like to consider several of these claims.

- Competition is strong, and any market power Telstra may once have had has been reduced to levels requiring no special regulatory tools.
- The way the ACCC applies the access regime is distorting investment, particularly in regional areas.
- The access regime reaches into competitive areas of the market.
- Regulatory processes are too lengthy (in particular, disputes under the access regime take too long to resolve).
- Competitors have been favoured over the incumbent.

The effectiveness of competition

Competition has developed strongly in some areas of the Australian telecommunications market, particularly the provision of long-distance and international calls and the mobile market. However, this does not mean that competition issues have been eliminated. Telstra still controls the vast majority of the (fixed) customer network, and any carrier seeking to offer retail services in competition with Telstra must be able to originate and terminate calls on Telstra's network. This implies substantial market power in call origination and termination. In the absence of access regulation, Telstra would clearly have the ability to use its market power to deny access to its facilities, raise access charges, or reduce the reliability with which a competitor can gain access.

Even in the mobile market, where competition appears strong at the retail level, market power exists in the termination of calls. This raises particular concerns for the pricing of fixed-to-mobile calls. The Commission has examined this issue in some detail and concluded that the regulation of mobile call termination is desirable.

The access regime and investment

When access providers and access seekers are unable to reach agreement on terms and conditions of access, the Commission conducts an arbitration process.

The Commission recognises that access prices are critical signals for investment, and has developed a cost-based approach which is forward-looking and based on the costs which an efficient operator would incur (known as total service long run incremental cost, or TSLRIC).

This has involved detailed work modelling the public switched telephone network (PSTN) and its costs. TSLRIC-based methodologies are commonly used by other regulators. It is hardly surprising that TSLRIC-based charges are lower than Telstra might otherwise be able or willing to charge.

Lack of new infrastructure investment in some regional areas does not necessarily indicate failure of the access regime.

It is more likely to reflect the reality that some areas, because of high build per consumer costs or low per consumer expected revenues, are unlikely to be able to support duplicate infrastructure based on current technologies and services.

Services subject to the access regime

Some carriers have argued that regulation extends to services that are now very competitive, including mobile telephone services. They cite market shares as an indicator of the competitiveness of the market. However, competitive markets are not usually identifiable by a single, one-dimensional measure. The nature and extent of competition are the outcome of both structural and behavioural factors. The Commission takes a range of these into account. When competition does develop in a market to the point where regulation may no longer be appropriate, the Commission can amend or revoke a declaration or issue an exemption from the standard access obligations. It is currently examining two such exemption applications.

Delays in the regulatory process

This is a valid complaint when it relates to arbitrations. Delays in resolving arbitrations have occurred because of the number of disputes notified to the Commission, and because of the Commission's determination to base its decisions on well-developed pricing principles, consultatively determined. These have taken time to develop, but once in place (and following resolution of the undertaking last year), the Commission expects to be able to conclude arbitrations much more rapidly. A number of final determinations have now been made, and unbundled local loop and GSM pricing principles are also being finalised.

The Commission made a number of recommendations to the Productivity Commission on the resolution of disputes, including giving the Commission the power to require and amend undertakings from access providers on the price and non-price terms and conditions of access to declared services.

Even-handedness

The Commission rejects claims that it has promoted the interests of competitors over those of Telstra. Requests from access seekers to declare services have been rejected on three occasions. Both current declaration inquiries concern the narrowing, rather than the extension, of the coverage of regulation, and most decisions do not give access seekers the outcome they sought.

Conclusion

Regulation of competition and access in telecommunications in Australia has turned out not to be particularly light-handed. That has been a reflection of the degree of market power exercised by Telstra and experience of its conduct, and also of the need to determine access prices carefully to achieve the long-term interests of end-users.

The Commission is particularly concerned that rights of access and terms and conditions of access promote competition and encourage economic use of infrastructure. This is not something that can be done without a lot of information and analysis. It has turned out not to be a natural outcome of commercial negotiations where there are large imbalances of market power.

Incumbents invariably are used to having things more their way than regulators are now willing to allow. At the same time they are often under intense commercial pressures, for example to defend market share.

Accordingly, claims that regulation is deterring investment will continue. However, comparisons show that regulatory decisions about returns on infrastructure in Australia tend to be higher in Australia than in other countries. Even with the lower returns in other jurisdictions there has been no drying-up of investment. The regulators here have been relatively generous. The investment environment in Australian telecommunications is more than healthy.

The full text of this speech is available on the CRF website at: <http://www.dcita.gov.au/crf>.

The regulator's role in negotiation and disputation — now and in the future

Presented to the SPAN–ATUG Industry Forum on 6 December 2000.

The post-1997 telecommunications regime provided for the Commission to arbitrate disputes about access terms and conditions for declared services when commercial negotiations

between access providers and seekers failed and when no approved undertaking applied.

The provisions were intended as a last resort for obtaining access agreements. In practice, they have been invoked for all declared services.

Thirty-five arbitrations, mostly on pricing, have been notified to the Commission since the regime started. Of these, 10 are for the PSTN, seven for GSM services (global system for mobile communications), seven for the local carriage service, four for the unconditioned local loop service and some for other services.
Ten have been finalised, while interim determinations have been issued for others.

Why commercial negotiations fail

Reasons for negotiation failures suggested in submissions to the Productivity Commission's review into telecommunications competition regulation include information asymmetries, incentives for parties to delay, perceptions that access seekers will gain a more favourable outcome from an arbitrated solution, and unwillingness on the part of some parties to negotiate in good faith. My view is that it is the major imbalance of market power between access providers (in most cases, Telstra) and access seekers.

The role of information

Infrastructure owners (frequently, but not exclusively, Telstra) have access to engineering and cost information which, in most cases, cannot accurately be duplicated by operators without infrastructure. Many submissions to the Productivity Commission suggested that lack of information — particularly on costs — was the main barrier to successful negotiation.

Access seekers felt more vulnerable and were hampered by lack of information when assessing offers on terms and conditions.

The need for a regulator to resolve disputes

Disputation alone does not justify an external regulator since commercial arbitration might well lead to a compromise between the parties. However, market power and information imbalances can lead to agreements that may produce inefficiencies and a poor long-term result for end-users.

The way forward

The environment for commercial negotiation needs to be improved so that satisfactory agreements can be reached without regulatory intervention. If market power and information imbalances remain, many negotiated outcomes will continue to be unsatisfactory, a regulatory mechanism will continue to be needed and the way it resolves disputes addressed.

Information in the current regime

The Commission provides ways to improve information flows when imbalances appear to cause problems. It was originally hoped that undertakings (submitted to and approved by the Commission) would provide starting points for negotiations. However, no approved undertakings are yet in place. Similarly, the pricing principles published by the Commission were expected to increase certainty about the regulatory parameters that would be applied by the Commission and so reduce the potential gains from taking a dispute to the Commission. However, it is now clear that the pricing principles alone are insufficient. The practicalities of reaching a price mean that more specific information — usually on costs — is needed so the principles can be applied.

In practice we find that the need for information may increase a party's desire to seek Commission intervention, as the Commission can make directions on information disclosure both before and during arbitration.

Improving information flows

To encourage voluntary information disclosure the Commission can act as an intermediary by processing data provided by one party and releasing it to the second party. This enables the second party to obtain information necessary for a decision without the first party revealing confidential data. The Commission has also encouraged disclosure of information in the course of mediations. However, the likelihood of achieving such disclosures without some form of compulsion by the regulator is uncertain. Our experience suggests that major concessions would be required, particularly on Telstra's part, if transparency were to be improved. Such concessions are unlikely to be made voluntarily.

When voluntary disclosure fails, mandated disclosure of information may be a way to advance negotiations. However, balancing the pro-competitive advantages of transparency against the legitimate commercial interests of those from whom information is sought is never easy.

Assessing claims of confidentiality is one of the more difficult issues faced by regulators in any regime.

The Commission is currently examining the question of information disclosure in the context of record-keeping requirements. An issues paper on the subject of regulatory principles for information disclosure will shortly be released by the Commission. The paper will be available from the Commission's website at: <http://www.accc.gov.au>.

Improving the regulatory dispute resolution process

Legislation imposes a requirement for public policy considerations to be taken into account. These include promoting the long-term interests of end-users — specifically, the promotion of competition, any-to-any connectivity and efficient use of, and investment in, infrastructure. Additional legislative requirements must also be met, including a 'reasonableness' provision.

In reaching its decisions the Commission has had to develop prices and pricing approaches that satisfy the requirements of the legislation. We have also had to apply the principles to particular matters, which in practice has meant building complex cost models of the services. These require an understanding of network architecture and have required the commissioning of expert input and the opportunity for extensive scrutiny. As these tools are developed they will provide the necessary basis for applying the legislative requirements to individual arbitrations consistently.

Apart from the delay from developing underlying principles and methods to implement them, arbitrations must currently be handled privately and individually. Common subject matter cannot be dealt with concurrently without the agreement of all the parties. The Commission has sought the agreement of parties to concurrent processes in two cases, but in each the access provider refused. An alternative approach may be to join all parties of similar disputes.

This is an area where the Commission's view has changed as a result of its experience. Initially, it was considered important that negotiations should be seen as bilateral matters. However, it has become clear that PSTN access, the unconditioned local loop service, and the pricing of local call resale are essentially 'vanilla' services (that is, not differentiated for different access seekers). There is no strong general argument against settling the terms and conditions of such services simultaneously for all participants. We have put this view strongly to the Productivity Commission.

We have suggested various legislative improvements to the Productivity Commission, including the ability, in limited circumstances, to require or amend undertakings, and clarification of our ability to publish arbitration determinations. This proposal in no way affects the coverage of regulation, only how disputes are handled.

Conclusion

As long as significant market power imbalances exist between access providers and access seekers it is unlikely commercial negotiations will produce satisfactory agreements on the terms and conditions of access to declared services. Improving the environment for such negotiations may reduce the number of disputes requiring arbitration, but is unlikely to eliminate them. This can only be achieved by eliminating the market power imbalance. For some services this will not happen in the short term.

However, if sufficient information, particularly about costs, were available to all parties, commercial negotiations may be more likely to achieve pricing outcomes that promote competition and efficiency. These are the public policy concerns that were seen to need an external regulator in the first place. To the extent that information disclosure requirements can mitigate those concerns, the need for direct regulatory involvement may be greatly reduced.

However, when access prices do need to be set by the regulator, we need to find a more efficient way of doing it.