**Essay on economic regulation issues for the ACMA Review**

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I have been asked to try and answer the following questions as a contribution to the Australian Government’s Review of the future structure of the Australian Communications & Media Authority (ACMA).

**Primary Questions**

* Will the communications sector of the future require a new style of regulator?
* Do the future characteristics of the communications sector mean that a sector-specific regulator should be responsible for all forms of industry regulation including economic regulation?
* Would switching regulatory models to a sector-specific model that included economic regulation enable the regulator to strike the optimal balance between achieving more immediate consumer benefits and long-term investment outcomes?

**Sub-Questions**

* What synergies exist in combining the economic regulator with the sector-specific telecommunications, broadcasting, radiocommunications and Internet regulator?
* What are the benefits and disadvantages of a concurrency regime, such as that in the United Kingdom?

I am answering these questions in London from a British/European/international perspective as it would not be appropriate for me to make specific judgements about, or recommendations for, the Australian landscape. Those should be made by others with a more specialist knowledge of specifically Australian conditions. For example, in earlier conversations with the Review Panel, the issue of regulatory skills shortage has been raised and in a country the size of Australia this may have implications for concentrating or not concentrating regulatory expertise in either the ACMA or the ACCC (Australian Competition and Consumer Commission) or the Vertigan report’s suggestion of a new “networks regulator”. Also, the Australian competition regime is a prosecutorial one, in contrast to the UK’s administrative system. The skills required for a prosecutorial system are different from those for an administrative system.

This essay derives from my fifty year career across the converging worlds of media, telecommunications and technology both in the UK and for example other countries such as the USA, my experience in the UK as founding deputy Chairman of Ofcom and Chairman of its Content Board 2002-2005, advisory work for the telecoms and media regulators - the IDA and the MDA - in Singapore and for Telecom New Zealand and Chorus Ltd in New Zealand.

**Will the communications sector of the future require a new style of regulator?**

Before looking at regulatory styles, it is important to be clear what “the communications sector of the future” could look like. Yet predictions are likely to be wrong either in substance or in timing so extraordinary is the pace and novelty of development. How many of us in say 1980 saw coming the revolution of mobile communications or of the packet-switched internet? Certainly not me.

But I would argue that the communications sector of the future is already significantly present, and deeply disruptive of past norms, past ways of thinking.

The communications sector of the future is digital, not analogue. “The digital communications sector” is a good title. The shared single digital language of 1s and 0s. Convergence, long prophesied, has happened, making traditional silo boundaries and traditional industry definitions redundant. With the arrival of Spotify and Netflix, what today constitutes “the broadcasting market”? Should Netflix be content regulated the same as Channel 7? If it should, could it be? No-one would describe Skype or Facebook as telcos but they perform many telco functions. Amazon streams to me (digitally) movies to watch and sends to me (physically) a new drain cover to replace a broken one. Digital 3D printing can make physical objects - the drain cover!

The information society, again long prophesied, is here, with all its extraordinary opportunities and its darker threats. Data Big and Small are at the heart of operations and competitive advantage. Marshall McLuhan’s “global village” is here, weakening territorial sovereign boundaries and challenging domestic laws and domestic regulation. The internet/world wide web is a global service. It is “multimedia” – that word like “global village” from the 1960s. The internet is borderless.

The digital communications sector is built around the all-IP (Internet Protocol) broadband infrastructure that carries voice, sound, data, software, text, still pictures, moving pictures to and from the user at home or in business, two-way and interactive but also one-way and streaming/broadcasting. This replaces the separately engineered and optimised networks of the past – the circuit-switched phone network, the telex network, the data network, the vision network. The all-IP platform, which does all of these things and more, is built on optic fibre under the ground or strung on poles, and on wireless signals of many kinds (wifi, NFC, mobile, broadcast) above ground. But unlike traditional over the air one-way broadcasting, the incremental costs per new user of content coming from the IP platform are not zero - because of bandwidth and server capacity. This economic fact – oft forgotten – will keep traditional broadcasting in business for many years to come.

Copper is gradually leaving the last mile network and being replaced by fibre. The narrowband circuit-switched public telephone network is on its way to extinction at the hands of packet switching (born along with the internet in the USA circa 1967). The traditional copper world is becoming extinct. Even the fixed open internet received at the desktop PC, itself a newish arrival, is today being eroded by the internet hidden in mobile apps. Vertical integration has not gone out of fashion but finds itself facing strong horizontal competition. And then strong horizontal competitors integrate vertically, for example Google moving from search and advertising (a service or application) into Google Fiber (transport network). Quad play is becoming the norm with the retail service providers of digital communications (what else does one call them?) packaging fixed phone, mobile phone, broadband and content (eg premium sport, premium music).

In this new world, services and applications can be and are independent of distribution platforms and independent of receiving devices. A DAB (digital audio broadcasting) radio station is today transmitted over the air via terrestrial television and radio signals, over the air from a satellite service, both over the air and over fibre/copper/cable from the internet. It can be linear (programmes in a specific set order of transmission at set times) or on-demand (the pioneering BBC i-Player). The receiving device is a radio receiver, a mobile phone, a tablet, a television set, a PC, a games station. A device manufacturer (Apple) ten years ago transformed the economics of the music industry (iTunes).

The four, not always cleanly distinguishable, layers of this digital communications sector are:

* infrastructure
* transport
* services/applications
* devices.

**Infrastructure** comprises a wide range of assets – ducts, poles, exchange buildings, cabinets, nodes, spectrum, unlit dark fibre in the ducts, masts and towers. This layer can be seen as two layers from a regulatory point of view – the empty duct to which infrastructure competitors to the incumbent(s) want access to lay their fibre (sometimes referred to as Layer 0), and the incumbent’s dark fibre or copper inside the duct which competitors also want access to (referred to as Layer 1, for example local loop unbundling).

The **transport** layer is the lit network delivering all-IP broadband through the international and trunk network, local access network, cellular network and back-haul by internet service providers/telcos/cable operators. Defining what is the backhaul network turns out to be not obvious, for example.

The **services/applications** layer is voice, messaging of all sorts, the world wide web, content services of all types from websites to traditional radio and tv channels, games, e-commerce etc. This layer can sometimes be split into two further layers by splitting out content from applications/services.

The **devices** layer includes everything from fixed phones to playstations, tablets to smartphones, tv sets to radio sets. In 1980 when I joined British Telecom, customer premises equipment was absolutely part of the network monopoly – real vertical integration. Not even answering machines, which would immediately generate revenue from the 30% of calls going through the BT network at that time but not being answered, were allowed to be open to competitive provision.

These four layers are of course “not always cleanly distinguishable” because they are deeply deeply interconnected in ways that the analogue wold was not. Apple, preeminent in devices, moves back into services (iTunes). Google, as noted above, preeminent in services (search) moves back into infrastructure and transport with Google Fiber. A telephone company (British Telecom) moves into broadcasting and bundling premium sport. A decision (commercial or regulatory) in one layer can impact other layers thus affecting market and consumer outcomes. The four layers are distinct yet also, ironically, converged.

So to regulatory style.

If one accepts that this is a reasonable prediction of what the future digital communications sector might look like, is looking like, and adds to any prediction a high level of uncertainty, then the first style requirement of a regulator should be the ability to be “holistic.” The regulator really needs to understand the whole and the sheer complexity of all four layers (or is it five or six?) and the way in which market players will operate across more than one layer to gain competitive advantage and the connections between layers, and where from a competition point of view the bottlenecks and significant market power lie and where well-functioning markets can be left alone to mature.

Given the unpredictability and speed of change, the regulator needs to be “agile” and not set in its ways. Sunset clauses and a commitment to genuine deregulation need to be part of that agility, refuting the oft-heard claim that turkeys never vote for Christmas.

Ofcom’s founding principles (Communications Act 2003, 3 3(a)) remain to the point twelve years on: “transparent, accountable, proportionate and targeted only at cases in which action is needed”. Proportionate and targeted are especially relevant to the fast changing digital communications landscape. They are close to agile and deregulatory.

The regulator needs to genuinely understand the modern consumer/end user. It is so much easier to understand the licensee/the regulated party because the sectoral regulator knows who they are and where to find them. Who is the consumer and where is he/she?

The regulator needs also to be pedantic. So much confusion is caused by terms being used without upfront clarity as to what they mean. In the UK “superfast broadband” is a good example. The regulator needs to be able to communicate clearly the complex.

In this complexity, the regulator needs to have and exert soft power, so that self-regulatory and co-regulatory models flourish and the regulator becomes a source of market knowledge and good data for all stakeholders including Government. Regulated companies should do good things not because they are told to do so by regulators but because those are rational and sensible things to do in well-functioning markets. The relationship between a sectoral regulator and the regulated companies (as noted below) allows this far more readily than can occur with a competition authority. Complaints to Australian broadcasters go first to the broadcaster, not to the regulator. This encourages broadcasters to genuinely own broadcasting codes of conduct and to own their, not the regulator’s, viewers and listeners. I tried, and failed, to import this innovation into Ofcom. The only UK broadcaster who does “broadcaster first” is the BBC.

Finally, the modern regulator of the digital communications sector needs to return to basics on a regular basis.

Why are we regulating this and does “this” still need regulating? Is it because of scarcity of resource (spectrum)? Is it because of monopolistic behaviour (last mile)? Is it because of market failure (public service broadcasting)? Is it because of the need to encourage investment (broadband roll-out)? Is it because of diversity and plurality (media ownership rules)? Is it because of the need for local voice and the need to grow local indigenous industries (the Australian film and television industry)? Is it to protect the consumer and citizen, especially children (content regulation and classification schemes)?

**Do the future characteristics of the communications sector mean that a sector-specific regulator should be responsible for all forms of industry regulation including economic regulation?**

I believe the answer is yes. The sheer complexity of the sector as described requires in my view intimate technical practical knowledge not general knowledge. For example, if the regulator is addressing open internet issues (called net neutrality in the USA), that regulator must understand how digital content networks (DCNs) work. It is best, from an efficiency point of view and from stakeholders’ point of view, if that industry knowledge is concentrated in one institution. Net neutrality (called the Open Internet in the UK) has been sorted out in the UK successfully by self-regulating codes of practice on, for example, traffic management, sitting on top of strong service-level competition feeding off BT’s wholesale Openreach access network. In the USA where strong service-level competition does not exist, net neutrality has become an FCC/regulatory stipulation (very much White House-backed).

At the heart of most of the difficult issues that face the regulator of the digital communications sector is, sooner or later, competition. That is not to say that content regulation, public service broadcasting, Australian content and media plurality are not important, but they are probably easier to separate out and address. They do also have some subtler competition implications.

Spectrum allocation decisions in the mobile industry almost always have a competition angle. The debate in Europe is intense between four mobile operators and consolidating down to three. Broadband policy is all about the pros and cons of infrastructure-based (US: facilities-based) competition versus service-level competition. Is the local access network in 93 percent of the Australian landmass where 10% of the population lives[[1]](#footnote-1) a natural monopoly?

When I licensed local radio stations in 2000 as Chairman of the Radio Authority (a precursor of Ofcom), there was always a debate between the preservation of local content in the public interest and levels of competition in the local market. As one Scottish station owner said to me brusquely: “If you license more competition in Glasgow, I will have to reduce my public service obligations.”

I agree with Vodafone in its submission to the ACMA Review: “…sectoral regulators can develop a culture of avoiding or ignoring competition policy principles in their decision making, indeed sometimes they feel that that are not qualified to make economic efficiency assessments of a particular issue….All public policy decision makers should undertake some form of cost/benefit analysis and assess how market forces can assist in delivering efficient and optimal outcomes….a communications and media regulator must have the capacity to recognise when and how its decisions have implications for competition and the capability to undertake the economic analysis required to effectively address those issues in its decision making. This is because, even without any change, its current responsibilities include a range of areas that are critical to competition in the telecommunications and media sectors, for example, spectrum management and technical regulation.”

**Would switching regulatory models to a sector-specific model that included economic regulation enable the regulator to strike the optimal balance between achieving more immediate consumer benefits and long-term investment outcomes?**

I believe the answer is yes. Regulation is all about striking balances between potentially conflicting constituencies. Cathryn Ross, the CEO of the UK water regulator Ofwat and Chairman this year of the UK Regulators Network: “Economic regulation is about aligning the interests of capital, and company management (not the same thing) with the interests of customers….For me, the essence of economic regulation is all about achieving that alignment – where companies and investors profit by doing what their customers want.”[[2]](#footnote-2)

But striking balances is not just for economic regulation. Deciding levels of acceptable nudity and swearing on television after the 9pm “watershed” in the UK in effect balances child protection with the freedom of adults to enjoy adult things. In the on-demand as distinct from linear world, the watershed concept is of course in danger. Deciding levels of media ownership in markets echoes economic regulation in deciding the balance between citizen concerns for plurality of voice versus investment risk. Cathryn Ross again: “…economic regulation is…all about allocating risk – some of that risk is inherent in the sector (eg risk of operational failures), some is created by the regulator (eg risk that outturns differ from assumptions underpinning the regulatory settlement…). It is through the allocation of risk that we create incentives and through incentives that we align interest.”[[3]](#footnote-3)

**What synergies exist in combining the economic regulator with the sector-specific telecommunications, broadcasting, radiocommunications and Internet regulator?**

I do not think synergies are the main or significant argument for creating one sectoral regulator for the digital communications sector – other than the obvious synergy of having sector-knowledgeable people co-located. The centrality of competition to a sectoral regulator’s thinking is a much bigger driver for creating one sectoral/economic regulator. There were not in my experience as Chairman of the Content Board at Ofcom any real synergies with the competition teams nearby. Content regulation does not have any obvious competition impacts until a judgement has to be made (by Government since it is policy) about “levelling the playing field” between traditional television and radio broadcasters and their streaming competitors delivered via IPTV. Should we level up or level down?

**What are the benefits and disadvantages of a concurrency regime, such as that in the United Kingdom?**

Ofcom by general account is seen as one of the most effective converged communications regulators with economic regulation powers in the world. I am of course biased. The concurrency regime with the Competition & Markets Authority (CMA) works and contributes to that success. In relation to market investigations, both the CMA and Ofcom have the powers to do Phase 1 reviews. But only the CMA has Phase 2 powers – eg imposing remedies. When Ofcom spent two years operationally separating BT from 2003-2005, the threat of referral to the competition authority was a most useful stick, alongside various carrots. The outcome in 2005, operational separation with equivalence of input requirements, which was then copied for example in New Zealand, was made more achievable by the combination of sectoral and concurrent powers. The CEOs of Ofcom and BT were able to have a relationship over a two year period that would not be possible in a purely competition environment. A sectoral regulator knows from day one whom they are regulating and can get to know the regulated in a way that is productive of regulatory outcomes without falling for regulatory capture. A competition authority by its very nature has a more detached, indeed “aggressive” relationship with companies that come, in one sense out of the blue, into its field of vision. The counter argument is that competition enforcement requires a highly objective mindset and sectoral regulators, in their proximity to their regulated entities, may lose that, unknowingly.

Concurrency concentrates the necessary expertise in one institution and allows the CMA to devote its time to many other pressing competition issues in other sectors (including of course non-sector-regulated), to thought leadership in competition thinking, and most important to mergers and acquisitions, in one sense its prime function. If it aint broke, don’t fix it, would be a UK view. It aint broke. Mergers and acquisitions in the UK have not been a point of friction between sectoral regulators and the CMA – indeed each learns from the other’s experience. The currently proposed big BT/EE fixed/mobile merger in the UK sees the CMA and Ofcom sitting closely together although on mergers only the CMA has powers. Not being a competition authority but having concurrent powers allows Ofcom to have a less adversarial relationship with regulated companies. This helps in achieving good outcomes, and also with self- and co-regulation models. Having these duties all in one place also does help with the task of trying to reduce ex ante regulation in favour of ex post general competition law – something around the world that is taking far longer than ever anticipated in the post-privatisation 1990s. Having ex ante and ex post in one organisation allows the optimal balance to be struck between the two and does not have to lead to a bias in favour of either one.

Relationships between Ofcom and the CMA are strong without the intrusion of regulatory egos. This is helped by the fact that the founding chairman of the recently created Competition and Markets Authority CMA (formerly the Competition Commission and the Office of Fair Trading) is Lord David Currie, the founding chairman of Ofcom in 2002. It is easy to overestimate the importance of process and underestimate the importance of leadership and human relationships.

One additional merit of the UK concurrency regime is that sectoral competition issues can be tackled by the sector regulator, funded from its levy on the industry, rather than from tax revenues. Given the pressure on the latter, this probably means more resource overall.

The United Kingdom Competition Network (UKCN) brings together the CMA with sectoral regulators in airports, air traffic, healthcare, gas and electricity, water/sewerage, railways, and Ofcom. UKCN is a forum which enables the regulators and the CMA to share expertise and experience with the view of achieving a consistent, high-quality approach to competition policy and enforcement in the regulated sectors, and to coordinate matters relating to concurrency.

For the concurrency regime to work well close cooperation between the sector regulator and the competition authority is required. And that close cooperation does require the competition authority to have a leadership role (Enterprise & Regulatory Reform Act 2013). Although Ofcom's record on competition cases was considered much better than the other sector regulators, it was still not as strong as some would have liked. With the new regime and the annual CMA Concurrency Report, the sector regulators, including Ofcom, have paid more attention to competition issues. A large regulator like Ofcom is likely to take the lead, but coordination with the competition authority remains essential. For smaller regulators without major competition expertise, this is even more the case. And the competition authority needs to make it clear that, if the sector regulator does not pursue competition cases in its sector, then the competition authority will - thus concurrency is real. Indeed there is a bit of competition! As one wag said back in the 1980s: “Why is there only one Monopolies Commission?”

This close working between competition authority and sectoral regulator with concurrent powers allows demarcation issues to be swiftly resolved. For example who is best placed to handle the competition issues raised by Google’s search algorithms if it is believed that Google has market power in search and if Google appears to be favouring its own services – the competition authority in my view. Similarly in this converged world, where a digital communications player is getting into other markets (for example Amazon into postal/physical delivery), the postal sectoral regulator may be best placed to adjudicate.

The disadvantages of the concurrency regime are that Ofcom is perceived in some quarters as being too big (it also does postal regulation and may in the upcoming Charter renewal of the BBC gain more regulatory oversight over the BBC). It can lose focus (diseconomies of scale) and avoid difficult areas in favour of matters that make good headlines (consumer regulation). It can lead to friction with politicians when the line between policy making and policy advice becomes blurred and politicians feel usurped by the regulator. Prime Minister Cameron, when in opposition, threatened to close Ofcom down as part of “a bonfire of the quangos”. Too bigness can lead to hubris and a reduction in deregulatory fervour and a lessening of the “presumption against regulation”[[4]](#footnote-4). There may be an unwillingness to take the risk and forsake ex ante in favour of ex post. Ex ante may be a safer haven (for the regulator). Also competition/economic regulation enjoys higher status in regulatory circles than, for example, content regulation (harm & offence, fairness & privacy, accuracy & impartiality). Thus it is easy for Ofcom to enjoy being a competition regulator to the detriment of concerns “beyond the market” that are about citizens not about consumers. Competition is mostly about consumers. But public service broadcasting, the universal postal service, child protection, media plurality, Australian content – these are all significant duties that should not be swamped by the excitement of regulators mimicking competition where no real competition (yet) exists, or where requiring competition might be a bad use of resources, eg genuine natural monopolies. John Reith’s founding vision of the BBC ninety years ago was of a public service broadcaster doing things people need as well as people want and hence, in its view, requiring a monopoly of provision. That monopoly lasted until the 1950s.

**Conclusion**

The Ofcom model combining economic regulation with other types of regulation has stood the test of time. I believe that the characteristics of the digital communications sector increasingly require this combination of skills. Judicial reviews and merits-based appeals[[5]](#footnote-5) keep Ofcom honest, neatly balancing accountability with transparency. Ofcom has sustained a strong relationship with Government which makes policy and sets the statutory rules, managing to remain steadfastly independent in the way in which that policy is interpreted/executed and those statutory rules are understood/implemented.

The digital communications sector of the future that is now appearing in the present is incredibly complex – the interconnectedness between the four layers has already been highlighted. The digital communications sector requires intimate understanding. As Cathryn Ross said:“…economic regulation is…all about allocating risk – some of that risk is inherent in the sector (eg risk of operational failures), some is created by the regulator (eg risk that outturns differ from assumptions underpinning the regulatory settlement…). It is through the allocation of risk that we create incentives and through incentives that we align interest.” At the heart of that understanding of risk, competition issues are the most difficult. It would be best to locate all that regulation in one place, but with close and strong recourse to the competition authority. In this way the right talent can be attracted from the regulated companies (without falling for regulatory capture), from the civil service and the public sector, from academia and the law. It should be seriously considered in Australia. But as I said at the start of this essay: “I am answering these questions in London from a British/European/international perspective as it would not be appropriate for me to make specific judgements about, or recommendations for, the Australian landscape.”

1. The ACMA-meeting our standard, ACMA, December 2014, page 6 [↑](#footnote-ref-1)
2. RPI Westminster Conference, London, 23 April 2015, page 2 [↑](#footnote-ref-2)
3. ibid. page 3 [↑](#footnote-ref-3)
4. Optus submission to the ACMA Review, page 3. [↑](#footnote-ref-4)
5. Ofcom has no great love of merits-based appeals because they suck in huge resource ie cost. The regulated companies can afford £1m on the table if it might bring them £20million. Ofcom is not in that position. [↑](#footnote-ref-5)