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TRANSCRIPT OF PROCEEDINGS

PRODUCTIVITY COMMISSION

DRAFT REPORT ON INTERNATIONAL TELECOMMUNICATIONS MARKET REGULATION

MR M. WOODS, Presiding Commissioner

TRANSCRIPT OF PROCEEDINGS

AT SYDNEY ON WEDNESDAY, 21 JULY 1999, AT 9.37 AM

MR WOODS: Ladies and gentlemen, welcome to the Sydney hearings for the Productivity Commission inquiry into international telecommunications market regulation. My name is Mike Woods. I am the presiding commissioner for this inquiry. As you will be aware, the commission's position paper was released in June. These hearings represent the next stage of the inquiry, with final submissions due by 30 July. I am required to report to the government by 23 August this year. I would like the hearings to be conducted in a reasonably informal manner, but I do remind you that a full transcript of evidence is being taken and will be made available to all interested parties.

I would like to welcome Ms Deena Shiff, Mr Robert Webster, and Mr Ian Littler to the inquiry as first witnesses on behalf of Telstra. Could each of you please state your full name and the position you hold for the record.

MS SHIFF: I am Deena Shiff, director, regulatory, Telstra Corporation.

MR WEBSTER: I am Robert Webster, business development manager in the global wholesale business unit of Telstra.

MR LITTLER: Ian Littler. I work in the strategy unit of wholesale and international as business development manager.

MR WOODS: Thank you very much. Would you like to make an opening statement.

MS SHIFF: Yes, thank you. Thank you for the opportunity to provide Telstra's comments in relation to the Productivity Commission's position paper on international telecommunications market regulation. I would like to briefly offer our views, firstly on the approach adopted in the position paper and some of the issues arising from the paper and, secondly, on the paper's policy recommendations or possible options.

Firstly, however, I would like to set out Telstra's global strategy for the record. Telstra views its international and wholesale business as two of the key areas of Telstra's growth into the future. Telstra's strategic goal is to be a globally significant full service commissions company in the 21st century. Our aim is to link all our businesses into a network, a communication's web encircling the globe, allowing seamless delivery of products and services to both corporate and wholesale customers.

To help achieve this global service web, Telstra plans to multiply the number of its switching points of presence, or POPs, around the globe, to increase our capability in offering services to companies operating around the world. Telstra already has extensive international network capability through cable and satellite agreements and equity agreements with global communications consortiums. To help support burgeoning electronic commerce by the Internet, Telstra has greatly increased its broadband cable capacity in recent years, and will expand that capacity in the near future. Planning is under way to boost the company's connectivity with a bold new

cable construction project which, if approved, will link Australia directly with Japan and connect with existing transpacific links into North America. The capacity of this cable will be far greater than any currently available.

The Asia-Pacific region will continue to play an integral role in Telstra's new global strategy. We have had business relationships in the region for more than 50 years, including a network build and operate relationship in Vietnam since the late 1980s. In Europe Telstra has a switch in the United Kingdom and will announce facilities in other European centres in the near future. New POPs are also scheduled for the US geared towards handling the exponential growth in Internet traffic, much of which flows into North America.

Turning to the position paper, the approach and some of the issues raised, and with that background in mind, I would like to address some of the issues in the paper. Let me note at the outset that it's not possible here to canvass all the issues and we will be providing the commission with a full comment in writing within the submission time-frame. There are numerous issues on which Telstra agrees with the commission, most notably with respect to the need for more equitable arrangements on Internet links to the US and with respect to the desirability of continued pressure for the liberalisation of overseas markets. It is only with market liberalisation that sensible commercial outcomes can be achieved with respect to international settlements and accounting rates. Those two basically go hand in hand and are led by market liberalisation.

Significantly, Telstra also agrees with the position paper's conclusion that the current strategies adopted within Australia in pursuit of international telecommunications market reform in general, and towards reform of the international communications payment arrangements in particular, are appropriate and have been broadly effective. We have already indicated we believe that in terms of the international environment, Australia itself has one of the most open and liberal markets for competition in international telecommunications services. The challenge is to obtain liberal access to overseas countries.

My primary concern today is with the commission's broader characterisation of the international telecommunications market, and how it is working. In addressing this, I want to start by emphasising the fact that in Telstra's view this should be at the centre of the commission's analysis. The fact that in 12 months, from 1 May 1998 to 1 May 1999, Telstra's average traffic weighted price per IDD minute decreased by fully 72 per cent is an extraordinary phenomenon. Prices today, in other words, are barely a third of what they were only a year ago. This is a dramatic rate of price decline and from it a clear inference can be drawn that this is a market in which communications are working and working well.

But it's not the picture a reader would obtain from the commission's position paper. Rather, the commission paints a picture of competition distorted and hindered, yet appears to cite very little hard evidence in support of its assessment. What it does point to indicators in numerous cases reported at third hand. On that basis, a range

of policy recommendations are set out. It's Telstra's view that many of the indicators the commission points to have little merit. As for the policy recommendations, some of these are plainly inconsistent with other statements the commission has made only recently. I will deal with each of these in turn.

Going to the indicators of performance, the analytical justification for the indicators selected is difficult to discern from the position paper and no framework is set out within which they can be integrated. Let me address two of these. The first is the level of Telstra's access charges for the PSTN; that is, the amount Telstra charges domestically for competitors accessing its network. The commission cites the ACCC's assessment of these charges. It also cites the views expressed by C and W Optus.

What the commission has chosen not to cite is Telstra's view that the charges it has proposed are strictly in line with its actual costs but, even more importantly, what the commission ought to have noted is that if the modelling approach used in its 1997 staff information paper on international telecommunications reform is to be believed, the level of domestic PSTN access charges can have virtually no impact on IDD rates. Some time ago Telstra provided the commission with an analysis that used Cable and Wireless Optus numbers to highlight the negligible impact of interconnect charges on IDD rates.

C and W Optus claims in its submission to this inquiry that in 1998 it was charging on average somewhere between 72 cents and \$1.07 per minute for international calls. C and W Optus also claims that the interconnect charge is currently 4.7 cents per minute and that this could be slashed to a fictional world's best practice figure of 1 cent per minute. In reality, Telstra's proposed interconnect rate as detailed in our undertaking to the ACCC was 3.76 cents per minute, although this doesn't represent the commercial rates that Optus enjoys.

But even putting this issue aside, the important point revealed in the C and W Optus data is the minuscule impact that a reduction in the interconnect rate would have on average IDD prices of between 72 cents and \$1.07 per minute based on the price information presented by C and W Optus, a reduction in the interconnect charge from 4.7 cents per minute to 1 cent per minute would at most, assuming that the full benefit was passed on to customers, reduce international call prices by 3 to 5 per cent. As the commission rightly identified in its 1997 information paper, issues of interconnection are of negligible significance in the market for international call services. The prominence that they are given in the position paper is consequently surprising.

Let me now turn to the second of the indicators the commission uses. This is the availability and pricing of various forms of non-switched capacity, international capacity, ranging from the purchase of ownership rights in undersea cables through to international leases. The paper claims these are overpriced and all subject to practical access restrictions. Without going through the commission's statement line by line, it is our submission that the analysis underpinning some of these assertions has gross

technical errors as when they compare at least to megabyte circuit, which is an end-to-end managed transmission service with an ownership claim on capacity in a cable, which is merely a claim on the physical transport layout and not the provision of a transmission service.

But there are some more basic issues that need to be set out. The facts are that international transmission is provided in a market that is undergoing explosive growth. In the short term, strong demand has tended to push prices higher than they would otherwise have been. However, in this area - as in others - the price in market mechanism works, and a strong supply expansion is now under way and is coming to fruition. The Australian situation is by no means unique in this respect. The last major transatlantic cables to go into service - TAC12 and 13 - sold out almost immediately, and since then demand has more than doubled. As for the transpacific routes, the last major increase in capacity occurred with the opening of the TPC5 in 1996. Since then, demand has risen from some 50 STM1s - each STM1 provides 155 megabytes of capacity - so close to 200.

It is precisely for this reason that carriers are investing in developing new facilities. For example, the Southern Cross cable, in which Telecom New Zealand and Cable and Wireless Optus hold major stakes, is scheduled to be in place by mid-2000. This cable will add some 40 inner ring to 80 outer ring gigabytes of capacity; that is, four to eight times the capacity of the current TPC5 cable, and will be further expandable to an estimated 480 gigabytes. Further substantial capacity additions will come from the SEA-ME -WE3 cable from Australia to Europe in which Telstra is playing a part.

Now, the commission claims that these investments are examples of inefficiencies and distortions but this is an argument that Telstra finds difficult to understand, much less support. Surely what we are seeing here is not inefficiency but rather the market at work; that is, the response of supply to strongly sustain growth in demand. These trends ought therefore to be commended rather than condemned.

Let me now turn to the policy recommendations or possible options proposed in the paper. These are divided between Australian telecommunications regulation and international negotiations. First, in relation to Australian telecommunications regulation I want to repeat the fact that in 12 months IDD prices have declined by over 70 per cent. This decline was not brought about by increased regulation; rather, it was the result of reducing the extent of regulatory constraint.

It's Telstra's strong belief that with the end of the duopoly period in July 1997 two changes occurred. Scope was created for new players to enter the industry, and many of the constraints until then imposed on Telstra's pricing; for example, in terms of non-discrimination provisions and post prices were relaxed. Combined, these changes have generated enormous benefits for consumers. Set against this background, some of the commission's recommendations are puzzling. For example, the commission urges the ACCC to consider requiring carriers to report and then disclose charges for services such as dedicated lines, yet consider what the

commission itself said in its 1997 report:

Given the increasing incentive for tacit collusion as switch service providers' market share increases, it may not be desirable for the ACCC to publish tariffs supplied upon its request. Standard competition policy safeguards alone may be a more effective means of preventing anticompetitive pricing.

Telstra believes there is a good deal of sense in that 1997 assessment. Even abstracting from the specific recommendations, there is a more general opportunity that has been missed. This is the opportunity to consider whether we actually need as much regulation as currently weighs upon this area of activity. Thus the paper cites the international benchmarking work released by the commission earlier this year. In that work, the commission compared telecommunications prices across a range of countries.

There is a vigorous and continuing debate about how such comparisons should be conducted, but one result on which there is agreement is that the countries in which consumers get the best deal are not necessarily those which are held up as models for Australian regulatory incrementing; that is, the UK and the US. Rather, it is the countries with truly light-handed regulatory regimes such as Sweden and Finland where consumers enjoy the lowest prices. What these results suggest is that there could well be gains from moving further and sooner from a reliance on industry-specific regulation to one based on economy-wide competition policy. Such a move would surely be consistent with an overall commitment to minimising the burden regulation imposes on the Australian economy.

In terms of the options proposed by the commission in relation to international negotiations we agree with the commission that fundamental reform of these arrangements is neither necessary nor desirable. It's also important to take into account the fact that whilst international telephony traffic is growing rapidly, it's also being very rapidly outpaced by Internet and data traffic, driven internationally by Internet e-commerce, multimedia and other manifestations of the so-called global information infrastructure. Telstra would like to see Australia's limited resources concentrated on issues such as these where Australian consumers stand to gain the most. Internet arrangements to the US are a prime example of this, and government and industry are playing a productive role in addressing this issue. This effort needs to continue. Thank you for your time in making this opening statement.

MR WOODS: Thank you. Gentlemen, do you have anything you wish to add?

MR WEBSTER: My specific area of expertise is on the Internet and I suppose just to endorse the comments that this is obviously, in terms of traffic carried and bandwidths to be provided - built, leased or in whatever fashion - is going to massively outpace telephony in the years to come as the basis of international telecommunications.

MR LITTLER: I'm fine, thanks.

MR WOODS: Thank you. Thank you for your opening comments. Can I commence the questioning by picking up some of the points you made there in those statements. The first one was reference to hard evidence. The commission remains welcoming of any hard evidence that participants wish to provide to the inquiry. It's a field where the cloak of commercial confidentiality is readily descended by many participants and therefore the commission - as with others in this area - can at times find it difficult to obtain the "hard evidence" that you referred to. But to the extent that, I take it, from your opening statements Telstra is willing to provide that to assist the inquiry, we would welcome your comments and look forward to working with you closely over the next couple of weeks.

MS SHIFF: Certainly, commissioner. Thank you for that offer. If there are areas where staff feel that there has been deficient disclosure we would certainly - and that underpins some of the conclusions that have been drawn, we would certainly welcome the opportunity to review that and see if we can be more helpful.

MR WOODS: I take that up readily. In terms of comments about the relative importance of interconnect rate to total IDD charges, would you agree that as the cost of transmission on the international cables and switching and the like reduced dramatically that the interconnect rate assumes relatively greater importance as part of the total charge for international calls?

MS SHIFF: It assumes slightly greater significance, say from 5 per cent to 10 per cent, as retail prices move closer to the sum of costs, including the costs of the international transmission link. But as a proportion of overall costs, they tend to maintain the same status in overall terms. In other words, there's no evidence that we can see that the domestic carriage component of the call in Australia is in any way retarding retail price reductions, or is likely to in the foreseeable future.

MR WOODS: But you agreed in your opening statement that there is a massive explosion in the supply of international cable, not only in terms of physical cable, but in capability of transmission along even existing cables - - -

MS SHIFF: Yes.

MR WOODS: - - - which will bring the economic cost of that element closely approximating zero in a few years' time, therefore the domestic interconnect end presumably is going to become an area of greater importance in terms of the total cost of the call.

MS SHIFF: But it's now 3 cents out of the total of an average of \$1. Some routes have fallen to 20 cents, but it's still only 3 cents of the total.

MR WOODS: That's in terms of price, but in terms of the underlying - - -

MS SHIFF: Total costs.

MR WOODS: - - - economic cost presumably it's - - -

MS SHIFF: I guess the assumption that you're making there is that the international transmission and the overseas domestic termination are going to fall to the dramatic levels that you are saying - - -

MR WOODS: Well, with international transmission the overseas domestic leg presumably will have some stickiness as well, but the - - -

MS SHIFF: Yes.

MR WOODS: - - - international transmission component as I understand it will be falling in terms of the underlying economic costs - not necessarily the price charged.

MS SHIFF: Mm.

MR WEBSTER: But we will have to convince all those underdeveloped countries with the high accounting rates to deregulate, because they will still make up a significant part of the cost of an international call, regardless of the transmission cost.

MS SHIFF: The accounting rate is by far the biggest cost.

MR WOODS: Yes.

MS SHIFF: So that's why we have emphasised, in terms of the issues that are confronting Australian consumers in terms of the cost structure that goes into the cost of an IDD call, it's the accounting rate to the non-liberalised regimes that is holding up the prices.

MR WOODS: Yes.

MS SHIFF: I mean, that is where the major issues are, and that's why we have placed a high degree of emphasis on market liberalisation as the key to unlocking that issue.

MR WOODS: Yes.

MS SHIFF: We have seen enormous evidence of market liberalisation and relaxation of parallel accounting and proportional return unlocking commercial opportunities on liberalised routes.

MR WOODS: And the main traffic routes are in fact on liberalised routes in terms of volume of traffic - is that not true - the US, UK, New Zealand?

MR LITTLER: Yes, they have an advantage both on - yes, on economies of scale

on transport - are always big, thick pipes with very low unit costs, and also in very liberalised markets where termination rates are close to costs because of competition. Where that doesn't apply, where either the routes are thin and/or the termination rates are set by monopolies or without any competition - that they clearly are high, and are by far the largest component of the cost of an international call.

MR WOODS: Yes, we understand the accounting rate for those non-liberalised areas forms the significant component of the cost.

MS SHIFF: I mean, there is another assumption that is embedded in your line of logic which is that the Australian domestic interconnect is somehow improperly set. I mean, the Australian domestic interconnect is a regulated charge. It's clearly subject to regulatory processes at the moment. In WTO terms it's been set on an optimised basis, forward-looking basis, rather than in relation to actual costs. There is, as far as actual forward-looking costs are concerned - our domestic charges are sitting at actual forward-looking costs, so it may be that it will go slightly under that in a regulatory process, whether through an arbitration or the formal lodgment of a price undertaking, but that process will deal with that issue. And hence whether it is or it isn't a trivial part of the overall cost pool or a significant part of the overall cost pool, it's not a regulatory issue; there is a device to deal with it within the Australian domestic context.

MR WOODS: I totally agree with that. I was pursuing at this point whether that cost, whatever its particular rate, for our main traffic routes to liberalised markets is a more significant component of the total charge than what was being portrayed in your opening statement, and I think we have covered that sufficiently at this point. There seems to be common agreement on the need to change the payment arrangements relating to Internet as particularly they apply to the United States, and you were urging in your opening comments that that be one of the main areas of focus of endeavour. In terms of particular strategies and approaches, what would Telstra be putting forward?

MR WEBSTER: The issue is very complex because the Internet technology and the service paradigm which underlies the Internet is vastly different, as I think everyone is aware, to the way the PSTN has evolved. So we are not pretending that there is any easy, readily available solution that we can recommend right now. What we do think - that there is a way you can look at the value exchange between networks, between infrastructure providers, that is more equitable, that recognises and compensates networks, infrastructure providers, for the access they're providing to someone else's customers, basically.

MR WOODS: Yes.

MR WEBSTER: Currently all of the US operators' customers can access our network in Australia without any direct payment to us or to the customers.

MR LITTLER: Including for port charges.

MR WEBSTER: That's correct. So to some extent, yes, we are concerned with the fact that bilateral half-circuit model doesn't apply, but we also recognise that the cost of those half-circuits is clearly going to decline with the technology, but it doesn't absolve the issue of port charges or access charges or compensation charges for allowing other people, other operators' customers, to access the network we have provisioned and maintained. So we are working through with the government, the Australian government, and in various other forums like APIC, trying to look at solutions with consultants and others on board. It's a long-term process and it's not going to be easy, because it will require a great deal of technical expertise and a lot of commercial negotiations to make it happen.

One of the drivers for this to happen, I believe, is the quality of service issue where in today's Internet you have a best efforts service paradigm which is fine to a point, but if people really want genuine quality of service guarantees over a public Internet infrastructure with multiple providers in any path of any particular transaction, it points to the need for some sort of interprovider payment system to give people incentive to provide that service. I think that's where the US or any other operators will find that they need to enter into some sort of new framework to make that happen.

MR WOODS: Thank you for that. To the extent that you are able to provide us with any updated information on volumes of traffic on Internet relative to PSTN, that would be quite helpful.

MS SHIFF: Yes.

MR WOODS: I mean, we all understand that there is rapid growth in the area and we captured the data as at the position paper, but even since then more data is available and we would look forward to your comments on that, including the extent to which Internet telephony may be capturing a greater proportion of the market. As we understood it, it was about 5 per cent in terms of equivalent of PSTN traffic, but whether you have revised those projections and see a greater role for it - we will look forward to some comments from you.

MR WEBSTER: We will try and provide some more up-to-date information.

MR WOODS: Thank you. In terms of options that we canvassed in the position paper, one was to explore whether there was any merit in more clearly defining what constitutes unacceptable conduct under the rules of conduct to clarify and perhaps to give greater warning to international players as to what we would not countenance. Do you see any merit in that as an approach, or do you consider that there is little behaviour on the part of international players at the moment that would warrant taking that further step?

MS SHIFF: I think our view would be that the current rules are sufficiently broadly drafted to encompass the sort of monopoly behaviour that you can experience on

non-liberalised streams in particular, and has been crafted to give some additional jurisdictional reach to the ACCC. The difficulty that one finds in this area is that, unlike domestic conduct matters, there is a tendency for players to strike commercial deals and move on, and to the extent that complaints have been made they have not, to my knowledge, proceeded to full-blown investigations, and hence we don't have very much precedent around the operation of the current rules. But there's nothing that we have seen that would suggest that the rules are defective. It may be that they are having a deterrent effect. We use them to shoot a volley over the bow occasionally.

MR WOODS: And there is nothing foreseeable in the future in terms of international players that would cause you to contemplate any change in those rules or a redefinition of the rules at this stage? You think they're adequate for circumstances, both as they now are and as you see them in the future?

MS SHIFF: They are certainly adequate, in my experience, to deal with traditional ripsawing-type behaviours for which those rules were really initially devised. Whether they're adequate to deal with market power issues in and around ownership of Internet infrastructure and bottleneck infrastructure offshore is a more interesting question, but I don't presume to know how to deal with that through the crafting of Australian domestically sourced rules. It seems to be more an issue of commercial and trade multilateral effort.

MR WOODS: Thank you for that.

MS SHIFF: As my colleague points out, in those types of issues there is coverage where you have got an affiliate of an offshore parent that you can capture jurisdictionally, but that might not always cover all situations.

MR WOODS: Particularly where the offshore operator operates in a non-liberalised market.

MS SHIFF: Yes, and there is no - - -

MR WOODS: Within the region, perhaps, even.

MS SHIFF: Yes.

MR WOODS: In our report we put forward some quantification of the benefits that have already come about from the liberalisation, and some of the costs that still remain in the international telecommunications, and drawing on some evidence that you had put before us, for instance on Internet traffic, we referred to excess costs of 45 to 72 million dollars. Again, if there are any updates on that that you could assist the commission with, that would be helpful.

MS SHIFF: Yes.

MR WOODS: In terms of pursuing non-liberalised markets, you put forward a number of countries where you thought targeting particular effort, and your criteria included possibility of actually achieving some gain in negotiations with those jurisdictions. Some other jurisdictions that come to mind such as China, Singapore, Indonesia, were not on your list as such, but is that because you don't give them priority, or you see that they have at least some timetables perhaps - in the case of Singapore - for progressive liberalisation? We have your subsequent communication.

MR WEBSTER: Yes, I am just trying to refer to it. Yes, I think we communicated that we thought that those countries which you mention - China, Indonesia, Singapore - the arrangements there are fairly well locked in stone in terms of the current structure, and unlikely to change significantly in a time-frame. I think we are talking about something in the near term here.

MS SHIFF: Yes, I think this list - this half a dozen that we gave you - was sourced from a request to I think DFAT - - -

MR WEBSTER: The WTO - yes - - -

MS SHIFF: - - - to help with the WTO round where we thought that some gains were possible, and where - whereas in the other countries they are obviously significant streams. We thought that there was no - it wasn't worth putting any effort there.

MR WOODS: And have recent developments in relation to, say, China's possible accession to WTO changed your views on anything?

MR WEBSTER: We would have to take advice from DFAT - - -

MS SHIFF: We would have to review - - -

MR WEBSTER: - - - because it's part of a whole - - -

MS SHIFF: We would have to review that, yes.

MR WEBSTER: - - - global list of shopping items from Australia. But there's no doubt that the China situation is, from our point - from a "cross" point of view - - -

MS SHIFF: It's very significant, yes.

MR WEBSTER: Yes, significant - and Singapore and Hong Kong have - well, they've done some new regulatory changes recently, I think, since that - - -

MS SHIFF: Yes.

MR WOODS: So it's a fluid list that is more opportunistically based - - -

MR WEBSTER: Yes.

MR WOODS: - - - in terms of where you can perceive - - -

MS SHIFF: Some trading opportunities - some trade liberalisation opportunities, yes.

MR WOODS: Okay. That's helpful. Thank you. While we're talking about that particular area, you recently announced further activity in Vietnam in terms of investment opportunities.

MR WEBSTER: I am not quite sure of the context of that announcement. We are coming to the end of our original contract which is, as Deena said, a build operate transfer arrangement - build operate - and there's been a whole range of different negotiations of extending or doing new business. I am not quite sure of the status of those. But we intend to be in Vietnam in some way in the long term, yes, after the expiry of the original contract arrangements.

MR WOODS: Okay, very good. I think that covers most of the items that arose out of your statement. If I can just go back to your initial submission. On page 7 of your original submission you were making reference to the international mergers, alliances, and acquisitions that were taking place, and you made reference to significant implications for relatively small markets such as Australia for local industry and local industry players.

MS SHIFF: Yes.

MR WOODS: You suggested this should be the subject of close monitoring. How do you perceive any changes in major international players since putting forward this submission? I am also interested that there be close monitoring but the question then arises - monitoring will tell you what's happening. The question, more importantly, is what can therefore be done about it from the Australian context, and I would welcome your views.

MR WEBSTER: It's a very broad point, and I was involved in it, but I suppose the issue is that in many aspects of telecommunications scale is very important in a business that's rapidly becoming a commoditiser - a commoditised business - where only scale will deliver very, very low unit costs, which will make you competitive not just in your own original, indigenous market, but globally. So we are aware that there are as many activities within big corporations for merging or putting in place alliances which rewards them with that scale, with that scope, with that coverage and makes them very, very competitive - so Australia is still, while being relatively intensive in terms of our usage of telecommunications, a small market in terms of our demography and our economy, relative to some of the global players.

So I suppose the future implication might be that those players will be able to

compete very effectively in the Australian market against what you might say is indigenous operators who have no alliance or equity relationships to leverage off to compete with those players. That might have implications for the regulatory structure as it exists, and for the objectives from the government or from the users' point of view. But Ian might have a view on global trends that can amplify that point in terms of what's happening in the mergers and acquisitions and the scale question.

MR WOODS: Thank you.

MR LITTLER: I think you've covered the point comprehensively but there is certainly a real danger that large global corporations will - domestic companies will just not be able to compete with the scale that they provide.

MR WOODS: And one of your strategies is to increase your points of presence so that you have end-to-end service delivery for your customer base.

MS SHIFF: Yes.

MR WOODS: Presumably that also gives you the opportunity to have an international base that can work - - -

MR WEBSTER: That's true, both in our own right and as a potential negotiating point for any equity or other alliance relationship we may enter. I suppose the worst-case scenario for a corporation that wants to grow is to become only a client of other companies, because you cannot compete with them; you'd just be a Net buyer.

MR WOODS: Yes.

MR WEBSTER: I suppose that minimises our opportunities for growth in the long term, if we sort of limit ourselves to the Australian market. I think Deena has already indicated that; that we intend to expand and we intend to be globally competitive, and to do that we have to be in touch with the trends of the market.

MR WOODS: You need to be active in that market, yes. Is there likely to be any change by the FCC to the treatment of Telstra in terms of requirements for parallel accounting and proportionate return requirements?

MR WEBSTER: I really can't answer that question. My own feeling is no, there is unlikely to be any changes, but - - -

MR WOODS: Perhaps you could update me at least with - - -

MS SHIFF: I think we need to update you on that, because I think the latest FCC policy has provided us with the opportunity to not have - to not sit within that traditional settlements policy, but we will take that on notice.

MR WOODS: Thank you, that would be helpful. One of the reasons for raising

that is that we canvassed the possibility of where there was established unacceptable conduct by foreign monopoly providers that perhaps we invoke the same sort of requirements upon them of proportionate returns and parallel accounting, but it sits uneasily with also strongly urging that such policies be dismantled wherever they apply internationally. So it would be helpful to understand where Telstra sits with the FCC on that, and whether you have any views on that point that we canvassed in the report as such anyway; whether they would be inappropriate policies to apply - - -

MS SHIFF: To require parallel accounting and proportionate return as a domestic sanction?

MR WOODS: Yes.

MS SHIFF: Yes, it's never been invoked, to my knowledge, and as a tool - it's really just a remedy and it's not - I mean, whether you use it as a remedy or not is I guess up to the regulator, but it doesn't strike me offhand as being inappropriate in the circumstances where you have ripsawing behaviour or exclusive arrangements that turn on overseas market power. The nice thing about it as a device is that it gives jurisdiction - it's hard to get remedies domestically that have offshore application, whereas this one does.

MR WOODS: Yes.

MS SHIFF: I think that's why it sits there in the tool-box.

MR WOODS: In the armoury.

MS SHIFF: Yes.

MR WOODS: I am conscious of some time constraints on some of the witnesses. I think that concludes the particular questions that I had arising from your submission and your opening statement. Are there matters that you would like to draw to the attention of the inquiry that we haven't covered in this hearing process to date?

MS SHIFF: No, I don't think so.

MR WOODS: I would be particularly keen to reinforce our desire to work closely with you on pursuing more hard data to either establish or to ameliorate some of the points and conclusions that we have drawn to date. The more that we can do that, the greater the strength of the final report.

MS SHIFF: Thank you.

MR WOODS: Thank you very much for presenting evidence at this point.

MR WOODS: I would now like to welcome Ms Seema Srivastava and Mr Alan Aked from the Rail Access Corporation. Thank you for coming forward and presenting a submission to the inquiry - and to remind you that a full transcript of proceedings will be made available to all interested parties. Could you please, each of you, state your full name and the position that you hold for the record.

MS SRIVASTAVA: Seema Srivastava, policy and planning analyst.

MR AKED: Alan Aked, general manager, telecommunications.

MR WOODS: Thank you very much. Do you wish to make an opening statement?

MR AKED: Yes, please, commissioner. The Rail Access Corporation is a New South Wales entity and it is considering entering the telecommunications market, although no firm decision has been made at this stage. The geographic areas of coverage that are being considered - and in order too - are city-wide - that's Sydney city-wide - statewide, national and then international, and it is because of that that we have made a submission.

Perhaps if we outline the place of the Rail Access Corporation in the rail entities of New South Wales and Australia and then give you some idea of how and where we stand, the third anniversary of the Hilmer reforms of the New South Wales railways is just coming up now. So the once vertically integrated State Rail Authority of New South Wales has been operating in a mode of four separate rail operators for that particular period.

The four operators are pretty simply - the vertically integrated entity was divided into two - "above the rail" operators, they quaintly call it in the rail business - the train operators, people who run trains - so there's a passenger train entity and a freight rail entity, and one below the rail operator - that is, the engineering company that maintains the track. The fourth entity is the Rail Access Corporation which owns the infrastructure. So the Rail Access Corporation runs a toll railroad. It charges access fees and pays for maintenance. Competition is being introduced above the rail in that there are multiple and many train operators - a lot of them very small - and there is competition being introduced below the rail with competition for providing services.

The telecommunications business or the telecommunications part of the old vertically integrated State Rail Authority is relatively small in terms of the Rail Access Corporation's revenue. It runs a cost on the revenue, because Rail Access Corporation at this stage is a cost-recovery entity - around about \$30 million out of a \$700 million annual operating fee, so about 5 per cent of the costs of running the infrastructure are associated with running the telecommunications.

The telecommunications division actually in terms of its positioning in the competitive environment isn't actually as old or isn't facing the same anniversary as the

rest of the railways in New South Wales in that in the original three years ago vesting and restructuring of the railways the telecommunications facilities and services were part of train control; were part of that group that provides for the control of trains, as air traffic controllers provide control for aircraft. And it wasn't until 12 months ago that the telecommunications entity - and that facility, train control facility, has been provided by the State Rail Authority, by the passenger train service. It wasn't until 12 months ago that the telecommunications operation was transferred out or was actually transferred to the Rail Access Corporation as a commercial purchase. They bought the business as a going business.

To give you some idea of the size and the scale, the telecommunications division provides telecommunications services that support the safe, on-time running of trains, and that's around about \$17 million a year cost on revenue. They provide telecommunications services and mostly corporate-style telecommunications services to the rail entities, to those four organisations, and there's around about \$11 million a year in that, and they provide other - let's call them commercial services - but they provide services to state governments and other entities that brings in a revenue of around about \$2 million a year. So that it is a small entity. You can see where it stands.

It's also worthwhile to give you some idea of how we are sitting with other rail entities, because the Hilmer reforms have applied to other states. I don't intend to speak for the other states, but I will just talk about the relationships and what we have been doing with them. With Victoria where there is a different form of integration or deaggregation of the rail entity, the telecommunication facilities Victoria-wide has been put into a statewide operation, and we have, from New South Wales - Rail Access Corporation - we have been able to put together agreements to put our right of way together so that we, as far as we can at this stage, have overcome some of those 19th century problems of different gauges in the railways. It's a very effective argument when you talk to these people - and similarly with Queensland.

From our point of view we are considering, as I was indicating, entering the telecommunications business at more than the most upstream services of right of way, dark fibre, microwave towers, raw capacity, wholesale capacity - in that sense - but there's little indication that our colleagues in Victoria or Queensland are looking at entering the market in the way we are. In terms of our submission, the principal messages or the principal points that we see as being - that we'd like you to take from our submission is that from the perspective of a potential new market entrant, what is needed is an effectively deregulated - regulatory framework within the international market.

We look at the national market entry as semi-daunting. When we look at our revenue against the telco revenues we are at a fraction of a percent of the size of the national market, which indicates to us that we have got quite a daunting task to get out there and get into the market, but when we look at the way the market is regulated, and the opportunities we have, it is not completely overwhelming; we are quite - we are forming the view that there is an opportunity for us to get into that

particular market without being squeezed out.

In the international market, even though it's further downstream, down the track for us, we have to say that the prospects where Australia is 2 per cent of perhaps the - as a figure of merit - of the world in business terms, that being a very, very small percentage of such a small percentage of the market - that internationally it's much more daunting for us to get into the business. We then actually look and we want to bring up another point to you as well, that most of our thinking is focused on what I'm calling midstream telecommunications services, compared with the upstream fibre, right of way-type of service, because in the international market we are just not in the business of participating in satellite or international cables - and also compared with downstream network services like telephone calls and Internet - international Internet.

The midstream services that we are focusing on are for some network services, the services characterised by frame relay, ATM, at that sort of level, and while we do accept that the regulatory regime - and effective regulatory regime needs to be based upon a flexible long-term approach to defining technology, and not be technology based - one of the things that at this stage when we look at it does concern us a little is that there is - we don't see the discussion and the regulatory issues in the area of our principal interest, we see - and quite reasonably, of course - lots of concern about the telephone call transfer rate and the Internet transfer rate.

Businesses and areas that we're not a small new entrant is probably particularly one of our - with our - from our position is not really looking to get into. We know that the fibre and the satellite areas are well defined. So that while we do applaud and do in general terms recognise the non-technology-specific issues of regulation and particularly the approach that's adopted by the ACA, we do point out that that probably is a - will cause us some extra barriers, perhaps, to getting into the business. That's a feeling that we have. We would be hard-pressed to substantiate that, however.

That brings us to the point that we really do support the fact that - well, support the issue that it's our view that the Australian government needs to take a vigorous role in pushing for an effective regulatory framework that is based on transparent, non-discriminatory pricing. We can only see that for new interests - that is an essential for us. From the perspective of a new market entrant, we do accept - we do take comfort from the fact that the competition has demonstrated benefits for Australian consumers. We look at what's happened in Australia, that there has been significant consumer benefits and capacity for the market to grow, and it is the regulatory regime that has emerged that will allow an organisation of our size and scale, if we wish, to - well, if we decide to, to be able to enter that particular market.

But, like Australia, the international telecommunications market is dominated by companies which we see sitting as - from our position - of market power, significant market power, and we recognise - or we identify, perhaps, that the Australian response, which we think has been appropriate and necessary - has been to allow competition within a meaningful regulatory framework. That is one that recognises

that the imbalance that exists in market power that's wielded in Australia by the incumbents - that's both the historical incumbent of Telstra - that organisation - and Optus, which was given access to market power, or monopoly power, for some particular period. We see that that - recognise that that's been appropriate in Australia.

But unlike nationally, we look and we cannot find a regulatory framework equivalent to the ACCC or the ACA in the international arena where regulatory recourse can be had. We see that as a particular disadvantaging - advantageous - for a new entrant such as ourselves. So from the perspective of a new market entrant or carrier investment conduct - we will be significantly influenced by the extent to which we can make a fair commercial return on our infrastructure. Our board has set a hurdle rate for our assessing the shareholder value which is based on an industry return and an industry hurdle.

To be able to effectively compete in the domestic telecommunications market new entrants such as ourselves need to be able to compete, not just at the national level, but also at the international level. We have recognised that and our competition will run out of steam, particularly at the midstream level that I talked about earlier. So while not immediately important to us if we enter the market, we recognise that it is - it will become - a driver for success for us, probably within - if we entered the market today - two to three years.

In light of existing inequalities and the move towards consolidation of market power, it's extremely unlikely that a new entrant such as ourselves would be able to negotiate for the recovery of fair costs at an industry level. We just don't have the horsepower, we don't have the capability to operate at an industry level to put that as an overhead on our - getting shareholder value. These inequalities are difficult to address at an industry level because of the market dominance - we see it as because of the market dominance of a few players, but they would be much more amenable to an international regulatory response.

Effective Australian government advocacy we see is needed to ensure that equitable pricing and settlement arrangements are established through that framework, and we do recognise that the Australian government has been particularly active in pushing for trade liberalisation within the market, the international market, and we do applaud that. What we would suggest is that the Australian government now needs to push vigorously for a more effective international framework in which is pricings and principles-based and expands its focus or does this in a way that the midstream services, some network services - as well as network services - form out, and we can start to see how they could help us in that particular area.

Lastly, our view is forming - though we have some difficulty in supporting it, but we think it's worth putting it out for you - that we should urge the government to task itself in the long term to consider developing and lobbying for international regulatory - in which the telecommunications companies or nations to a dispute can bring, by consent, matters to be arbitrated and conciliated. Thank you.

MR WOODS: Thank you for that opening comment and thank you for bringing to the commission's attention the thoughts of Rail Access Corporation from the perspective of a potential new entrant into this market. That's quite helpful. You make reference, both in your submission and in your opening statement, to the technologically neutral approach to regulation of the ACA, but you are also - as I understood it - suggesting this may create some barriers for entrants such as yourself. Have I got that right?

MR AKED: Yes, commissioner.

MR WOODS: If you could elaborate on that a little for me, that would be helpful.

MR AKED: Our view is not completely in concrete on this particular issue, but what we find is when we - we accept, because - the ACA's view that if they become technologically based they'll have to pick a technological winner, and the market is probably better at doing that than the regulator - and that because of rapid changes in technology they would be falling out. The thing or the issue that causes us the most concern is that when we look through all the submissions, when we look into the market, when we look everywhere we see upstream services well catered for and handled in the international arena, and network services - that is, the services like telephone calls, Internet calls, where you've got ending-to-ending kind of activity and addressing. But some network services, the services that sit between the two, just don't appear out there in the international area.

Now, we have got a major concern with that in that - well, let's be going back. We're not quite sure why that is, that - that is the expression of the way the regulatory approach is being taken. If it were intrinsic or embedded in that - in the non-technology regulatory approach, we would urge a change to make sure that it's taken into account, though we would feel that perhaps a stronger focus on it as a general approach to midstream services rather than particular midstream service technologies could be the appropriate way to work for us.

MR WOODS: Thank you for that elaboration. In your submission you also drew attention to the disadvantage Australia is placed at in terms of connection to the Internet, to the US. Do you have any particular views that you would wish to put to the commission as to how those disadvantages may be overcome?

MR AKED: No, commissioner. Our experience base in this area is probably small - is certainly smaller than anybody else's. The reason we have a concern is that we would see the natural progression of our - of midstream services into Internet-like services - IP protocol services - and the resolving of the public switched Internet transfer arrangements - we would see as a bellwether for our being able to effectively negotiate and provide part of what - the national part of non-public IP based services.

MR WOODS: Thank you. A final point: again in your submission you draw attention to the mergers and alliances which are taking place at the international level

and yet, having recognised the market power that that gives them, that doesn't seem to be totally dissuading you, as an example of a new entrant, from finding a niche where you can contribute in that particular industry sector.

MR AKED: No, it's not - I think I used the - commissioner - used the words at the beginning - and nationally it's semi-daunting, internationally it's more than that. We look at the size of these groupings that have been put together and put our hand up and say, "Australian government, please help us."

MR WOODS: Are there any other matters that you wish to draw to the attention of the commission this morning?

MR AKED: No, thank you, commissioner. I think we have canvassed the issue that we have some - we've thought about and we have some ability to contribute.

MR WOODS: Our final reporting date is 23 August, but to the extent that during that time you further develop your own market appreciation, we would welcome correspondence from you to keep us abreast of your developments.

MR AKED: Certainly, we will certainly - - -

MR WOODS: Thank you very much for providing evidence to the commission at this inquiry.

MR AKED: Thank you, commissioner.

MR WOODS: Are there any other witnesses who wish to come forward? There being no such other witnesses, I will close these hearings and remind all parties that final submissions are due on 30 July to allow us time to complete the report and present the report to government by 23 August. Thank you very much for your attendance.

AT 10.51 AM THE INQUIRY WAS ADJOURNED ACCORDINGLY

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