TELSTRA CORPORATION LIMITED

Submission to the Productivity Commission

Review of Regulatory Burdens on Business: Social and Economic Infrastructure Services

27 February 2009

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A. EXECUTIVE SUMMARY

Telstra welcomes the opportunity to provide a submission to the Productivity Commission's Annual Review of Regulatory Burdens on Business: Social and Economic Infrastructure Services.

Governments around the world, including here in Australia, are spending billions of taxpayer dollars in an effort to kick-start economic activity. Correctly, investment in infrastructure is seen as a sensible place to direct much of this money. Infrastructure projects create jobs and economic activity in the short term and underpin productivity and economic efficiency over the longer term.

But public money is only one lever for Governments to pull. Reform of outdated regulation is a means of encouraging private sector investment. Efforts to identify and reform regulations that stifle investment should be re-doubled in this time of economic crisis. Otherwise, it is a case of driving with one foot on the accelerator and one on the brake.

With its reams of red tape, telecommunications reform is an obvious starting point. Telstra endorses the use of regulation where it is necessary – for example, to ensure access to infrastructure where true bottlenecks exist, to manage scarce spectrum resources and to protect consumers. However, where there is a need for it, regulation must provide a net benefit to society and, in the case of access regulation, regulatory certainty and a return on investment commensurate with the risks involved. The telecommunications industry is characterised by excessive regulation, much of which is redundant, inconsistent with regulatory best practice or poorly implemented.

Telstra submits that the Commission should give priority to reviewing and recommending reform of those regulations that demonstrably constrain investment in this crucial segment of the economy.

Investment is constrained by regulation that creates uncertainty.

The overwhelming imperative in telecommunications in 2009 is the need for investment, specifically in next generation broadband networks.

Telstra's submission demonstrates that the telecommunications access regime embodied in Part XIC of the Trade Practices Act, which affords significant discretion to the ACCC in its administration of the regime, and hence significant uncertainty as to outcomes, continues to stifle investment in much-needed competitive broadband infrastructure.

Investment in regulated telecommunications infrastructure is declining, and the unwillingness of any party to invest in expanding or upgrading existing infrastructure to deliver high-speed broadband without regulatory reform is testament to the shortcomings of the regulatory regime.

Such uncertainty has to be removed. Telstra proposes for consideration a set of principles upon which to base a new telecommunications access regime to replace Part XIC, including a transition path. Such a regime would have the objectives of promoting efficient investment and consistency of regulation – the principles underpinning every Australian access regime except that for telecommunications. Telstra seeks alignment of the new telecommunications access regime with the best-practice features of the access regimes in other industries.

Investment is also stifled by regulation that constrains cost recovery.

Part XIC is implemented in ways that prevent Telstra from recovering the costs of services it is required to provide to competitors. This has a chilling effect on investment, not only by Telstra, but also its competitors who are incented to use below-cost services built with Telstra's resources rather than invest their own.

Telstra proposes the reform of Part XIC to adopt the objectives of the national access regime in Part IIIA of the Trade Practices Act – in essence, consistent regulation that promotes efficient investment – and to pursue best practice regulation by aligning with improvements in other access regimes since 1997.

The Universal Service Obligation (USO) is another example of regulation that constrains cost recovery. The failure to calculate and recognise the costs of delivering the USO in high-cost locations deters and distorts investment.

Investment is hindered by red tape

The telecommunications industry suffers under a mountain of red tape, much of which has not been subject to a rigorous cost-benefit analysis.

Specifically, the telecommunications-specific market conduct provisions in Part XIB of the TPA are duplicative and unnecessary. They were transitional measures to protect embryonic competition that have no place in a fully competitive market where their powers and provisions entirely duplicate other regulation.

The retail price controls also serve no useful purpose as pricing in the telecommunications industry is now driven by competition, not regulation.

There is even regulation still in place that is utterly redundant – it is either exhausted or has been replaced. That this regulation remains in place is symptomatic of the lack of focus on efficient regulation of the telecommunications industry.

Much of the red tape reporting required of Telstra is redundant or at the very least could be rationalised to make it more efficient. Accounting separation, for example, has been superseded by operational separation – and yet Telstra continues to be required to duplicate reporting under both regimes.

Any regulation that fails to afford a demonstrable net benefit or results in the micro-management of carriers' operations by regulators through granular reporting that serves no regulatory or other purpose must be repealed or reformed.

B. INTRODUCTION

Telstra welcomes the opportunity to provide a submission to the Productivity Commission's Annual Review of Regulatory Burdens on Business: Social and Economic Infrastructure Services.

Telstra provided a submission to the Taskforce on Reducing the Regulatory Burden on Business (the "Taskforce") in November 2005. Almost all of the burdensome regulation Telstra identified in that submission persists today.

Telstra appreciates that the Commission's focus is the unnecessary burdens of regulation *on businesses*. Telstra submits that the burden of onerous regulation in telecommunications has wider ramifications than its direct impact on individual regulated businesses such as Telstra and, to a lesser extent, its competitors. Regulation which is onerous and/or creates regulatory uncertainty has a stifling impact on investment and the broader economy, as its adverse implications extend beyond the communications industry to the Australian consumers and businesses which are its customers.

Telstra's submission on the burdens of telecommunications regulation focuses on the regulatory burden from two perspectives:

1. regulation that harms investment, and
2. regulation with no demonstrable net benefit.

Section C outlines the size and causes of the regulatory burden in telecommunications, strongly endorsing the Taskforce recommendation as to the importance of addressing the causes of over-regulation in addition to removing burdensome regulation[1].

In Section D, Telstra demonstrates that the telecommunications access regime embodied in Part XIC of the Trade Practices Act (TPA), which affords significant discretion to the ACCC in its administration of the regime, and hence significant uncertainty as to outcomes, has stifled investment in much-needed competitive broadband infrastructure. The ACCC's exercise of its discretion to prevent efficient cost recovery has a chilling effect on investment, not only by Telstra, but also its competitors who are incented to use below-cost services built with Telstra's resources rather than invest their own.

In light of this, *Section E* offers two sets of recommended reforms to Part XIC of the TPA. The first is a set of minimum required reforms to address the most grievous issues identified in this submission to facilitate urgently needed broadband infrastructure investment. The second recommends a comprehensive reform of Part XIC to align it with best practice access regulation. The point is not to seek to remove regulation where regulation is necessary but to ensure the scope of regulation is tightly focused and that terms and conditions of access are certain and send the correct build/buy signals.

Section F highlights the impact of regulatory obligations imposed on Telstra that preclude cost recovery and recommends a path for reform. In particular, it outlines how current USO regulation – which enshrines and perpetuates an under-recovery of the cost to Telstra of a mandate to make standard telephone services and payphones reasonably accessible to all Australians on an equitable basis – deters and distorts investment, and recommends a path for reform.

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[1] Taskforce on Reducing the Regulatory Burden on Business, *Rethinking Regulation*, 7 April 2006, chapter 7

The balance of Telstra's submission outlines key areas of telecommunications regulation that are redundant, duplicative, inefficient and/or simply unnecessary, and hence provide no net benefit.

This includes, in *Section G*, Part XIB of the TPA, which should be repealed on the basis that it is duplicative and unnecessary, or at least reformed to address its most pressing failings.

Section H reiterates views already expressed by the Commission[2] that retail price controls in telecommunications are redundant and should be removed.

Section I highlights that industry taxes collected by ACMA are funding social policy with national benefits, and recommends that economic and administrative efficiency favours broadening the funding base for a number of levies to the Government's tax base rather than just the telecommunications industry.

Section J sets out the 'low hanging fruit' – regulation contained in Telstra's carrier licence which is utterly redundant and hence ripe for removal, without even requiring legislation to do so.

Finally, *Section K* examines five cases of completely redundant and/or vastly inefficient regulatory reporting requirements and recommends repeal or significant reform of these requirements. These are:

- Accounting separation – which should be repealed as it is entirely obsolete in light of operational separation;
- Retail tariff-filing;
- CSG reporting – inconsistencies must be addressed and reporting requirements should be rationalised to ensure a net benefit;
- CSG extreme failure reporting – which should be repealed as simply unnecessary in light of consistent favourable reports; and
- NRF level 3 reporting – which should be reformed to prevent inefficient and unnecessary micro-management of Telstra's service operations.

Telstra notes and supports the Commission's direction that "'regulation' should be taken to include the way particular laws and rules are administered and enforced". The examples cited in this submission will bear out that the way regulation is administered and enforced may be the source of the burden it imposes to a far greater extent than is apparent from a simple reading of the legislative framework.

In telecommunications access regulation, however, it is the legislative framework itself that affords the regulator the broad discretion which is the source of investment-stifling uncertainty, and the legislation itself that by its silence facilitates inconsistent regulatory approaches, and which allows outcomes such as below-cost pricing, the risk of which cannot be countenanced by potential investors.

Ultimately it is the regulation itself which permits its application and enforcement to impose undue burden on business, and regulatory reform is needed to address not just this burden, but equally importantly, its causes.

[2] Productivity Commission Inquiry Report, *Review of Australia's Consumer Policy Framework*, 30 April 2008, pp.31, 113, 115.

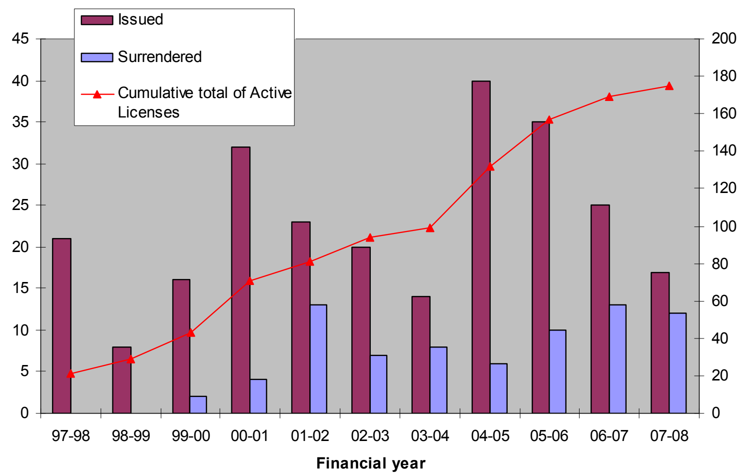
C. THE REGULATORY BURDEN IN TELECOMMUNICATIONS

C.1 The size of the regulatory burden

Since the current telecommunications regulatory regime was introduced in 1997, the extent of competition has grown dramatically. Specifically, a recent ACMA publication[3], reported that as at 30 June 2008

- the number of licensed carriers totalled 172. Of this total, 17 licences had been issued in the preceding 12 months, reflecting low barriers to entry. See Figure 1.[4]

Figure 1: Trends in carrier licensing, 1997–98 to 2007–08



Source: ACMA.

- There were four mobile carriers operating six mobile networks in Australia. Three of these carrier networks covered at least 96 per cent of the Australian population while the other three carrier network covered at 98.8 per cent of the Australian population.[5]

- There are four operators of HFC networks covering 2.6 million homes in metropolitan and regional centres.[6]

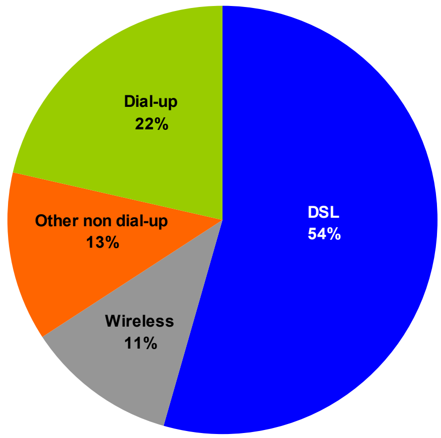
- It was estimated that there were 678 internet service providers (ISPs) in operation using a range of different access technologies[7]. Figure 2 provides a breakdown of the market by access technology.[8]

- There are 372 fixed-voice service providers operating in Australia. Of these, 210 offer service over the conventional fixed-line network (the public switched telephone network or PSTN) including PSTN pre-selection providers and resellers. Another 268 service providers operate in the VoIP

[3] ACMA, *ACMA Communications Report 2007-08*, November 2008
[4] Ibid. p.24
[5] Ibid. p.23
[6] Ibid. pp.16, 23
[7] As previously stated, the Australian Bureau of Statistics reports that 37 ISPs have more than 10,000 active subscribers.
[8] ACMA, Op.cit. p.21

market including service providers, resellers and system integrators, and 106 provide both PSTN and VoIP services. ACMA research suggests that 12 per cent of internet households have used a VoIP service. [9]

Figure 2: Internet take-up by access technology, 30 June 2008



Source: ABS, Internet Activity Survey, Cat: 8153.0, June 2008.
Note: Other non dial-up includes ISDN, satellite, cable and other non-dial-up technologies.

Recent findings of the ACCC reveal that:

- Telstra, Optus, AAPT, Amcom, Ergon, Nextgen, PIPE Networks, Primus, QLD Rail and Soul all operate backhaul networks in metropolitan and regional areas across Australia – in fact some backhaul routes are serviced by three or more operators[10]; and
- Approximately 23 ISPs have invested in their own DSLAM/MSAN equipment to enable DSL service provision, with most investing in ADSL2+ equipment. As at 30 June 2008, 3010 exchanges were enabled to provide ADSL services covering 98 per cent of SIOs.[11]

By rights, these fundamental changes in the market should have seen significant regulatory rollback. Yet, on the contrary, regulation has expanded, adding cost, bureaucracy and complexity, diverting resources from productive use and stifling investment.

In Telstra's submission to the Taskforce in 2005, the size of the regulatory burden was articulated. As at August 2005, there were 348 instruments applying to telecommunications, compared with only 20 which were in operation in July 1997.[12] The total number of substantive pages of regulation has risen from 1,602 to 10,013 for the same period.[13]

The number of declared services has increased from 8 in July 1997 to 12 in January 2009[14] – see Table 1.

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[9] Ibid. pp25-26
[10] ACCC 2008, *Communications Infrastructure and Services Availability in Australia 2008 report* Melbourne, p.14.
[11] ACCC 2008, *Fixed Services Review Declaration inquiry for the ULLS, LSS, PSTN OA, PSTN TA, LCS and WLR: Discussion paper,* Melbourne, November.
[12] Telstra Corporation Limited, *Submission to Taskforce on Reducing the Regulatory Burden on Business*, 25 November 2008, pg. 14
[13] Ibid., pg. 14
[14]See the ACCC's declared services register at http://www.accc.gov.au/content/index.phtml/itemId/777921 (Accessed 23rd January 2009)

Table 1

	1997	2007
Number of carrier licences	9	170
Number of declared services	8	12
Number of pages of regulation	1,602	10,013

C.2 The causes of the regulatory burden

Telstra submits at the outset that simply recommending the reform, reduction or repeal of regulation which has been shown to be unduly burdensome should be only the first step in the Commission's review. Stopping there will not prevent the imposition of further regulatory burden in the future.

Telstra endorses the strongly-expressed views of the Taskforce on the importance of addressing the underlying causes of over-regulation[15], and the measures it recommended, including the need to undertake cost-benefit analysis, strengthen Regulation Impact Statement adequacy requirements, conduct selective post-implementation reviews after 1-2 years, provision for 5-year sunsets (provided that they are true sunsets, requiring a demonstrable net benefit to retain the regulation) and 5-yearly review of non-sunset regulation.

Addressing the causes of over-regulation should be a key priority of the Commission.

While the former Government largely accepted the Taskforce's recommendations on this point[16] there has been little evidence of their adoption in telecommunications regulatory decision-making.

It is Telstra's submission that the blowout in the regulatory burden in telecommunications is a result of four factors:

1. The whole regulatory framework exhibits a bias for regulation;
2. Telecommunications access regulation affords extremely broad discretions to the ACCC to regulate, and to determine the terms of supply of regulated services;
3. In general, there is insufficient accountability for regulatory decisions – an absence of merits review or impact analysis for regulatory decisions with significant impact on business, on investment and on the economy; and
4. Infrequent (if ever) review of whether existing regulation remains necessary.

1. The whole regulatory framework exhibits a bias <u>for</u> regulation.

The presumption in favour of regulation is reflected in both the legislative framework – the broad discretions it affords the regulators to decide to regulate –

[15] Taskforce on Reducing the Regulatory Burden on Business, *Rethinking Regulation*, 7 April 2006, chapter 7
[16] *Rethinking Regulation – Australian Government Response*, 15 August 2006, pp.75-89

and in the actual decisions of the regulators. In particular under Part XIC, it has proved far easier for the ACCC to regulate than to deregulate; and while the ACCC's evidentiary hurdle to set terms of supply (including price) is low, the evidentiary hurdle required of an access provider to have terms accepted in an undertaking is impossibly high.

Under Part XIC of the TPA, the ACCC may impose access regulation – 'declare' a service – where declaration is in the long-term interests of end-users[17]. Declaration triggers standard access obligations in relation to the service[18] and allows the ACCC to set terms and conditions of supply in the event of a dispute between the parties.

Ostensibly, the test for deregulation is the same. Under the legislation, the ACCC must not make a decision to exempt a service unless the exemption is in the long-term interests of end-users[19]. In short, the legislation requires the following chains of reasoning:

To declare:

- Is declaration in long-term interests of end users?
- If yes, ACCC can declare the service.

To exempt:

- Is exemption in the long-term interests of end users?
- If yes, the ACCC can grant the exemption.

In practice, this is not how the regime has been implemented (see Example 1), with the hurdle for declaration demonstrably lower than the hurdle that has been set for deregulation – the latter so high as to be almost impossible to clear.

Example 1 – Declaration & non-exemption of WLR/LCS

In July 2006, the ACCC re-declared wholesale local calls, and declared wholesale line rental for the first time.[20] Yet at the time, the ACCC acknowledged that it had "not received sufficient information to determine whether there is effective competition in particular areas where some form of competitor infrastructure exists"[21]. Rather than collect this evidence and target regulation on the basis of empirical facts and data, the ACCC regulated the service nationally and then invited parties to apply for exemptions from regulation where there was competition.

Telstra subsequently filed a series of exemption applications with the ACCC, seeking the removal of regulation of wholesale local calls and wholesale line rental in 387 exchange areas. These applications were supported by extensive evidence demonstrating the existence of competition in those areas. That evidence included that there were at least eight competitors in some exchanges. In August 2008, the ACCC granted exemptions in 284 of these 387 areas, subject to certain conditions, including a 12-month lag time for the exemptions to take

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[17] Section 152AL(3)
[18] Section 152AR
[19] See sections 152AS(4), 152ASA(4), 152AT(4), 152ATA(4)
[20] ACCC, *Local Services Review, Final Decision,* July 2006
[21] ACCC, *Strategic Review of the regulation of fixed network services – ACCC position paper,* June 2006, p16.

effect.

The ACCC's decision was appealed to the Australian Competition Tribunal by iiNet and was overturned.[22] The Tribunal decided that it was not enough to show that many competitors had entered the market. It was not enough to show low barriers to entry or the availability of alternative regulated services. Instead, Telstra had to provide detailed evidence relating to the behaviour and market intentions of each competitor, and Telstra's response to those competitors, before any exemption could be granted. This included information such as Telstra's competitors' willingness and operational ability to compete in the market and to increase their market share. The Tribunal added that even if Telstra was able to establish all of that, it still may not grant the exemption and remove regulation, reflecting the Tribunal's view that the decision to exempt is still ultimately one of discretion.

Under Part XIC the ACCC's discretion is so broad that it can regulate a service while admitting that it is not in possession of all relevant information, yet according to the Tribunal an exemption from regulation requires detailed evidence of Telstra's competitors' business plans, and even then may not be granted.

Telstra is seeking judicial review of the Tribunal's decision. As well as highlighting the investment-stifling uncertainty created by a broad discretion to regulate (discussed in the next section), this example highlights that Part XIC applies the same test to regulation and deregulation decisions but that in the implementation of Part XIC there is a clear bias toward regulating and against de-regulating.

By making it easy to regulate, and extremely difficult to de-regulate a service, even in the face of overwhelming competition, the regulatory burden inevitably expands.

2. *Telecommunications access regulation affords extremely broad discretions to the ACCC to regulate, and to determine the terms of supply of regulated services*

Discretion to regulate

As indicated above, the ACCC has a broad discretion to declare a service. The legislated criterion is the long-term interests of end-users, which comprises the following elements:

(a) the objective of promoting competition in markets for carriage services and services supplied by means of carriage services (the listed services);

(b) the objective of achieving any-to-any connectivity in relation to carriage services that involve communication between end-users; and

(c) the objective of encouraging the economically efficient use of, and the economically efficient investment in (i) the infrastructure by which the

[22] Australian Competition Tribunal Decision of 22 December 2008, File no 2 of 2008, Application by Chime Communications Pty Ltd.

listed services are supplied; and (ii) any other infrastructure by which listed services are, or are likely to become, capable of being supplied.[23]

While these criteria are exhaustive and some guidance on interpretation is provided, the TPA provides no guidance on how they are to be weighted.

Example 1 – the declaration and non-exemption of WLR/LCS (above) highlights the breadth of interpretations and application of these criteria.

This is in contrast to the national access regime in Part IIIA of the TPA, and other effective access regimes recognised under Part IIIA such as those for gas and electricity access, in which the discretion to regulate is subject to greater prescription and accountability:

- Under Part IIIA, third party access regulation can only be applied to *genuine bottleneck infrastructure* where regulation is *required* to promote competition.
- For infrastructure to be treated as a bottleneck and therefore subject to regulation it must be established that the facility is uneconomic to duplicate.
- Part IIIA requires that access promotes a "material" increase in competition. This avoids incurring the costs and risks of regulation in situations where the competition promoted would be trivial.
- This higher threshold also promotes a stronger focus on direct infrastructure-based competition.
- In both the gas access and national access regimes, the decision to declare a service is subject to merits-based review.

Discretion to set access terms

The legislated criterion for determining the terms of access under Part XIC – by acceptance of an undertaking or an arbitral determination – is that the terms must be 'reasonable', by reference to a non-exhaustive list of factors to which regard must be had[24]:

- Whether the terms promote the long-term interests of end-users;
- The legitimate business interests of the relevant carrier or carriage service provider, and its investment in the facilities used to supply the service concerned;
- The interests of persons who have rights to use the service concerned;
- The direct costs of providing access to the service concerned;
- Relevant operational and technical requirements;
- The economically efficient operation of a telecommunications service, network or facility.

Because this list is non-exhaustive, and because some of these factors reflect competing interests, it leaves significant residual discretion in the hands of the ACCC, again bound only by the nebulous concept of the long-term interests of end users.

Discretion to set prices

In contrast to the national access regime under Part IIIA of the TPA (see Example 2), under Part XIC there are no binding pricing principles. There is not even a requirement that regulated access prices cover the efficient costs of providing the

[23] Section 152AB
[24] Section 152AH

services, including a return on investment commensurate with risk. While regard must be had to the direct costs of providing access, there is no weighting of the elements of reasonableness, and no requirement that these costs actually be recovered.

> *Example 2 – Part IIIA has legislated pricing principles*
>
> For infrastructure regulated under Part IIIA of the TPA, the following binding pricing principles apply[25]:
>
> (a) regulated access prices should:
>   (i) be set so as to generate expected revenue for a regulated service/s that is at least sufficient to meet the efficient costs of providing access to the service/s;
>   (ii) include a return on investment commensurate with the regulatory and commercial risks involved;
>
> (b) that the access price structures should
>   (i) allow multi-part pricing and price discrimination when it aids efficiency;
>   (ii) not allow a vertically integrated firm to discriminate in favour of its own downstream operations, except to the extent that the cost of providing access to other operators is higher; and
>
> (c) that access pricing regimes should provide incentives to reduce costs or otherwise improve productivity.

3. In general, there is insufficient accountability for regulatory decisions – an absence of merits review or impact analysis for regulatory decisions with significant impact on business, on investment and on the economy.

Limited merits review

Taskforce recommendation 7.18 was that:

> *There should be provision for merit review of any administrative decisions that can significantly affect the interests of individuals or enterprises.*

In its response the Government agreed in principle to the recommendation, but pointed to the Administrative Review Council (ARC) guidelines "What decisions should be subject to merits review?" which set out factors that may mean that merits review is not appropriate.

In telecommunications, ACCC decisions to declare a service and arbitral determinations of price and non-price terms of access to declared services are not open to merits review. Yet these decisions have a significant business impact on both the access provider and the access seeker. For example, the difference between Telstra's efficient costs of providing the ULLS and the ACCC's indicative price is worth $8 million per month to Telstra.

In its recent review, the ARC recommended a review of the availability of merits review in telecommunications:

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[25] Section 44ZZCA

"Many regulatory decisions—for example, in the telecommunications and the trade practices areas—can have a significant impact on individual business enterprises. The Council's review of complex business regulation suggests that there could be regulatory areas such as these ***where review of the extent to which merits review is and should be available would be timely****."* [emphasis added][26]

Telstra endorses this recommendation.

Limited regulation impact analysis

The office of Best Practice Regulation requires a Regulation Impact Statement (RIS) when a regulatory proposal is likely to have significant impacts on business and individuals or the economy.[27] According to the OBPR "preliminary assessment tool[28]", it is likely a RIS will be required if the regulation:

A. Imposes *business compliance costs* to be incurred and these costs are not low. Low costs are generally suggested if the number of businesses included is few and costs are trivial/negligible (when compared to the size of the business involved) ; and/or
B. Necessitates *other impacts* on business and individuals or the economy and these impacts are not low. There needs to be consideration had to:
   i. Does the proposal "potentially affect the number and range of businesses in an industry?"
   ii. Does the proposal "potentially change the ability of businesses to compete?"
   iii. Does the proposal "potentially alter a business's incentives to compete?"
   iv. Does the proposal "potentially impact on consumers?"
   v. Does the proposal "potentially have any other impacts on business and individuals or the economy?"

The impact of telecommunications regulation does not stop at the regulated entity – it has impacts on investment and the economy – and does not always arise from the regulatory instrument itself. For example, the impact of ACCC decisions under Part XIC comes from the regulatory decisions enabled by the legislation. While legislation and regulatory instruments in the telecommunications portfolio – such as retail price controls and operational separation – have generally been the subject of regulation impact assessment, the ACCC decisions with the biggest impact – which also are not subject to merits review – are not generally scrutinised by the OBPR. The ACCC does complete regulation impact statements when it issues record-keeping rules, but when it declares a service, issues pricing principles and accepts or rejects undertakings – decisions which have a significant business, competitive and wider economic impact – no such analysis is undertaken. See Example 3.

[26] Administrative Review Council, *Administrative Accountability in Business Areas Subject to Complex and Specific Regulation,* 28 November 2008, page 36
[27] http://www.finance.gov.au/obpr/ris/gov-ris.html (Accessed 23rd January 2009)
[28] http://www.finance.gov.au/obpr/proposal/ria-guidance.html#form (Accessed 23rd January 2009)

Example 3 – Impact assessment of key ACCC decisions

The table below illustrates the limited extent to which the ACCC undertakes an assessment of the impact of its decisions.

Type of Regulatory Decision	Is a regulation impact statement generally completed?
Arbitration Decisions	No
Assessment of Undertakings	No
Declaration	No
Setting of Indicative Prices	No
RKRs	Yes

The following examples illustrate the magnitude of the revenue impact on Telstra alone of ACCC pricing decisions which are not subject to regulation impact analysis:

- The ACCC's current indicative price[29] for the line sharing service (LSS) is $2.50/service/month. Telstra's last undertaking for LSS (which was within the ACCC's previous indicative price range, but was nonetheless rejected by the ACCC) was $9/service/month. The value of the revenue impact of this differential is over $3.2million/month.[30]
- The ACCC's price for ULLS fell to $12.30/service/month for Band 2 for 2005/06. Telstra has established via its undertaking process that the cost of providing the service in Band 2 is more like $47/service/month, and Telstra is seeking $30/service/month. The value of the revenue impact of this differential is over $8million/month.[31]

4. Infrequent (if ever) review of whether existing regulation remains necessary

A review of redundant regulation in Telecommunications highlights the absence of a proper process of review to ensure that regulation that is no longer required is removed. A number of regulation that are completely redundant, because they have been exhausted or superseded, remain on the books. For example:

- Clause 13 of Telstra's Carrier Licence, which required Telstra to introduce Local Number Portability and, pursuant to Clause 14 expressly ceases to have effect once arrangements have been agreed, is still a Telstra licence condition a decade after that occurred;
- Operational separation regulation has been superseded by accounting separation yet it remains in place even though the key authorities agree that the regulations should be removed. See Example 4.

[29] ACCC, *Review of the Line Sharing Service Declaration, Final Decision*, October 2007
[30] Based on the total number of LSS SIOs as at 31 December 2008; monthly charges only.
[31] Based on the total number of ULLS SIOs as at 31 December 2008; does not include Band 1, 3 and 4, connection charges or other charges

Example 4 – Accounting separation

The accounting separation regulatory regime remains in place despite the introduction of operational separation which was expected to replace it.

Accounting separation was first introduced in 2003 and revised in 2004. There are 4 parts to the framework: 1) current cost accounting, 2) price monitoring through imputation testing, 3) non-price terms and conditions and 4) ACCC monitoring of competition in the corporate business customer group. Since 2005 the ACCC stopped reporting on corporate customers because the market is competitive and the obligation is out-dated. The ACCC has not used the current cost accounting results as an input to any of their regulatory decision-making: it serves no useful purpose.

The operational separation requirements introduced in 2006 fully subsumed, improved and expanded the imputation testing and non price terms and conditions elements of accounting separation, making the old regime redundant. Further, the operational separation regime added new regulatory dimensions such as information security, information equivalence, customer responsiveness and organisational separation requirements upon Telstra.

Despite this, the accounting separation regulatory requirements continue. Imputation testing and non price terms and condition reports are still prepared by Telstra and submitted to the ACCC quarterly, for the ACCC to consolidate and comment on quarterly. Similarly current cost account reports are still prepared and submitted several times a year. Telstra still complies with all the associated auditing requirements. Accounting separation is a time consuming, expensive regime that has unnecessarily persisted for over 2 years since operational separation was introduced to supersede it.

- The ACCC annually requires telecommunications carriers to provide it with details of their infrastructure deployment. This is designed to allow the ACCC to assess the extent of the rollout of infrastructure in competition to Telstra's fixed network. Yet to date the ACCC has declined to act on this information to commence the wind back of regulation, even where it is evident that the state of competition is such that regulation is unnecessary, nor even to publish a competition report based on the information. Instead, the ACCC requires industry participants to proactively prove the case that areas are competitive, based on third-party information, before it will reactively deregulate.

Example 5 – The regulated wholesale transmission services

In December 2007, the ACCC issued an industry RKR that required nominated carriers within the telecommunications industry to provide the ACCC with details of their infrastructure deployment every year in March.

In 2004, the ACCC re-declared the wholesale transmission service, but decided that where there were two other optical fibre competitors on a particular route in addition to Telstra, the route was sufficiently competitive for regulation to be withdrawn (with a 12 month transition period). In November 2008 the ACCC granted Telstra exemptions from regulation of transmission services where it was established that Telstra plus two other optical fibre competitors existed.

However, in its draft decision to re-declare the transmission service for another 5 years, the ACCC has refused to refer to the industry RKR data that it already has to exempt additional areas that are now competitive.

It has also refused to consider the information it will receive from industry in March this year and in future years during the 5 year declaration to determine whether there might be a case for rolling back regulation in areas where the ACCC's Telstra plus two threshold is reached. Instead, the ACCC will sit on the information received annually from industry, and wait for parties to apply for an exemption from regulation, requiring them to prove to the ACCC that competition exists.[32] As industry participants do not have access to the industry-wide information gathered by the ACCC, they are forced to submit third party data, when the best information sits with the ACCC. It also demonstrates that the ACCC is content to continue to regulate areas that are likely to already be competitive, and to only deregulate reactively if and when it is asked to examine the information.

This places an unnecessary burden upon the telecommunications industry in two ways. First, nominated carriers are required to annually provide the ACCC with information about their infrastructure rollout when it appears the ACCC has little intention of using that information to target regulation to the areas where it is most needed. The ACCC could instead simply ask for that information to be provided if and when it received an application for an exemption, rather than burden industry with having to provide detailed information on an annual basis. Second, it places an unnecessary burden upon industry participants to prove the case that competition exists in particular areas and that regulation should be removed, when the ACCC itself possesses the necessary information that would allow for that assessment to be commenced.

C.3 The need for enduring solutions to prevent an expanding regulatory burden

An enduring solution will of necessity address the four problems identified above.

To address the causes of over-regulation, Telstra makes the following recommendations:

R1. That all telecommunications legislation, regulatory instruments and decisions to regulate, which have the effect of imposing regulation be required to have a specified sunset date, being no more than three to five years from its enactment (depending on the type of regulation), upon which date the regulation will cease. The regulation can only be reinstated if a positive case for its retention has been made on the basis of analysis of the 'problem' and full cost/benefit analysis of the regulation and its alternatives as solutions to the problem.

R2. That a mandatory pricing principle be implemented, consistent with that in section 44ZZCA of the TPA, requiring that regulated access prices should be set so as to generate expected revenue for supply of the regulated service/s to access seekers that is at least sufficient to meet the efficient costs of providing

[32] ACCC, *Domestic Transmission Capacity Service: An ACCC Draft Report on reviewing the declaration of the domestic transmission capacity service*, February 2009, p.24

access to the service/s and include a return on investment commensurate with the regulatory and commercial risks involved.

R3. That the elements of the long-term interests of end-users as set out in section 152AB of the TPA be amended to give primacy to the objective of promoting efficient investment in competing telecommunications facilities.

R4. That merits review by the Australian Competition Tribunal be introduced for ACCC decisions to declare a service and arbitral determinations under Part XIC of the TPA, or alternatively a new body be appointed to provide merits-based oversight of these regulatory decisions.

R5. That the ACCC be required to prepare regulation impact statements for all regulatory decisions that meet the criteria in the OBPR assessment tool. These should be prepared and published before the decision is made, and should specifically address the level of consistency in ACCC decision-making and the extent to which efficient costs are recovered across all relevant services, recognising that consistency of regulation and cost recovery are critical elements of the impact of regulatory decisions on investment.
This requirement would apply to at least the following decisions:

- *To declare a service;*
- *Issue of pricing principles;*
- *Issue of model terms and conditions and the publication of indicative prices;*
- *Any arbitral determinations that are not consistent with published pricing principles and model terms and conditions.*

D. ACCESS REGULATION IS STIFLING INVESTMENT

D.1 Introduction

With the global financial crisis governments around the world are looking for ways to stimulate their economies. Much of the focus to date has been on injecting public money into the economy but governments should also be looking at ways they can stimulate private investment.

The economic value – driven by direct investment, productivity improvements and job creation – of investment in high-speed broadband infrastructure is significant, all the more so in the current economic climate.

In January 2008, in a presentation to the new Obama Administration, IBM's global CEO produced research showing that investing USD 10 billion to provide high-speed broadband would create 498,000 jobs in a year.[33]

Two thirds of the 500-plus CEOs surveyed by Australian Industry Group in October 2008 believed their businesses would benefit greatly from faster broadband. The AiG concluded that:

> *"a faster broadband network is likely to result in considerable increases in <u>all</u> areas of business activity for Australian firms."*[34]

The demand for ICT investment is unprecedented –

- The amount of Internet traffic doubles globally every two years. In 2007 there were 45 Gigabytes of digital data created, captured or replicated for each of the world's 6.5 billion inhabitants. This is forecast to increase six-fold.[35]
- Cloud computing is growing at 40% per annum.[36]
- In January in the US alone, 133 million unique visitors made over 2 billion visits to the top three social networking sites - Facebook, MySpace and Twitter[37]. Facebook, the world's largest social networking site, estimates it added 600,000 users a day during January 2009[38] and that more than 3 billion minutes are spent on its site every day[39].

Yet this investment is not forthcoming under the current telecommunications regulatory regime. In fact the latest ABS capital expenditure data shows that capex in the communications services sector declined by 0.4% in real terms in 2007-08. Outside this sector, capex grew by 9.8% in 2007-08.

Investors require regulatory certainty. This section elaborates on the simple fact that the telecommunications access regime does not afford them that certainty, making investment in potentially regulated infrastructure highly unattractive.

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[33] *The Digital Road to Recovery: A Stimulus Plan to Create Jobs, Boost Productivity and Revitalize America,* The Information Technology & Innovation Foundation, Jan 2009, http://www.itif.org/files/roadtorecovery.pdf

[34] *Ai Group and Deloitte National CEO survey - High Speed to Broadband: Measuring industry demand for a world class service,* Oct 2008, http://www.aigroup.com.au/policy/reports/archive08

[35] *The Diverse and Exploding Digital Universe*, IDC White Paper, Mar 2008, http://www.emc.com/collateral/analyst-reports/diverse-exploding-digital-universe.pdf

[36] IDC Press Release, *Software as a Service Market Will Expand Rather than Contract Despite the Economic Crisis, IDC Finds,* 26 January 2009

[37] http://siteanalytics.compete.com/Facebook.com+myspace.com+twitter.com/?metric=uv

[38] http://www.insidefacebook.com/2009/02/14/facebook-surpasses-175-million-users-continuing-to-grow-by-600k-usersday/

[39] http://www.facebook.com/press/info.php?statistics

D.2 Uncertainty of regulated terms

In Section C we highlighted the broad regulatory discretion available to the ACCC – both to regulate a service and to determine the terms of access to a service, with no binding pricing principles, or a requirement that regulated access prices cover the efficient costs of providing the services, including a return on investment commensurate with risk.

Unfortunately the ACCC has exercised this broad discretion in inconsistent and unpredictable ways. The resulting uncertainty has virtually frozen investment in any telecommunications infrastructure at risk of regulation.

(i) Pricing inconsistent with efficient cost recovery

Regulators, governments and authorities on regulation have recognised the paramount importance of promoting efficient investment by providing for full recovery of efficient costs.[40] Failure to allow such recovery undermines investment not only in the regulated service (and in substitutes for that service, such as facilities that might otherwise be built by access seekers) but in all services actually and potentially subject to regulation. Regulated entities cannot have confidence that costs will be recovered if neither regulation nor regulators require it.

Yet the ACCC considers efficient costs to be but one factor it must take into account in applying the legislative criteria[41]:

> *When assessing whether the price terms in an undertaking are consistent with the legislative criteria, in particular that the terms of the undertaking are reasonable under section 152AH of the TPA, the ACCC has generally relied on various sources of information that may assist it in determining whether the proposed undertaking price is cost-based and likely to satisfy the legislative criteria the ACCC must consider. Such information may include, for example, comparing the proposed price term with the access provider's internal transfer price, with the retail price, with other international benchmarking prices. Cost model estimates are another source of information that has been useful in assessing the reasonableness of price terms in an undertaking.*[42]

In fact, there have been instances of express determinations of regulated prices at below cost, as demonstrated in its pricing principles for wholesale local calls.

(ii) Cost standards are inconsistent

Investor confidence in efficient cost recovery will also be undermined if regulators do not adopt cost standards that are consistent, predictable and transparent. Nothing sends a signal more chilling of investment than the inappropriate exercise of regulatory discretion or even the threat of such inappropriate exercise.

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[40] See, for example, speeches by the ACCC's Michael Cosgrave: *The regulation of Australia's broadband market* (21 August 2007, AFR Broadband Australia 2007 Conference, Sydney); *Telecommunications regulation and regional Australia* (20 May 2008, Australian Telecommunications User Group, 2008 Regional Conference, Canberra)
[41] For example, see ACCC, *Assessment of Telstra's Unconditioned Local Loop Service Band 2 monthly charge undertaking, Draft Decision*, November 2008, section 6.1
[42] Ibid. p.33

The High Court only recently emphasised this in proceedings in which it upheld a finding by the Tribunal that the ACCC, in reaching an access pricing decision, had "*put aside any well recognised asset valuation methodologies and had been idiosyncratic*".[43] Importantly, the High Court noted a principle that is no less true in telecommunications than in other industries, namely that:[44]

> *The greater the degree of uncertainty and unpredictability in the regulatory process, the greater will be the perceived risk of investment.*

The cost standard that has been chosen and used by the ACCC in telecommunications since 1997, for some but not all declared services, is TSLRIC+[45]. In choosing to rely on TSLRIC+, the ACCC has emphasised, in claims the Tribunal has subsequently endorsed, that the TSLRIC+ standard:

- Is consistent with outcomes in a competitive market;[46]
- Permits full recovery of efficient costs, while not requiring end-users to pay for inefficiencies in service provision;[47]
- Provides signals that can guide efficient build/buy decisions; and thereby[48]
- Enhances competition in dependent markets; and[49]
- Promotes the long term interests of end users.[50]

Clearly, however, these claims would not be fulfilled where the cost standard is not consistently applied. In two recent draft decisions the ACCC has expressly queried the consistency of TSLRIC+ with the legislative criteria and indicated that it is contemplating setting access prices which are not consistent with efficient costs. Perversely, in one instance the ACCC is claiming that TSLRIC+ would produce prices that are too high, and in the other case prices that are too low, to be consistent with the statutory 'reasonableness' criteria, including the long-term interests of end users.

In proposing to depart from TSLRIC+ in the case of the November 2008 draft decision to reject Telstra's ULLS undertaking, the ACCC proposes a novel methodology which involves selecting from a range of alternative cost measures for each element of the service without any suggestion of consistency. This inexplicable change of direction occurred, despite the submission by Telstra of a world-leading TSLRIC+ cost model. See Example 7.

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[43] *East Australian Pipeline Pty Limited v Australian Competition and Consumer Commission* [2007] HCA 44, [92]

[44] *East Australian Pipeline Pty Limited v Australian Competition and Consumer Commission* [2007] HCA 44, [49-50], emphasis added.

[45] See Telstra (2008), *Telstra's ULLS Undertaking is Reasonable*, 4 April 2008, section C.2.

[46] ACCC (1997), *Access Pricing Principles – Telecommunications: a guide*, July 1997, page 29

[47] ACCC (2002), *Pricing of unconditioned local loop services (ULLS) – Final Report*, March 2002, p.16

[48] ACCC (1997), *Access Pricing Principles – Telecommunications: a guide*, July 1997, page 29-30

[49] ACCC (1997), *Access Pricing Principles – Telecommunications: a guide*, July 1997, page 30

[50] ACCC (2006), *Assessment of Telstra's PSTN and LCS Undertaking, Final Decision*, 29 November 2006, p.45, see also Re Optus Mobile Pty Ltd & Optus Networks Pty Ltd [2006] ACompT 8, 22 November 2006 [107] and In Re Seven Network Limited (No 4) [2004] 187 FLR 373.

Example 6 – LCS priced at RMRC where RMRC is below TSLRIC

When the local call resale service (LCS) was declared by the ACCC in July 1999[51], the ACCC said that it would be likely to use an avoidable cost approach to determining the price of the declared service.[52] It eventually adopted a retail minus retail costs (RMRC) approach. For WLR, which was declared in July 2006, a RMRC approach has also been used by the regulator. Yet other services, even those which were used as alternatives to these services such as PSTN Originating and Terminating Access for local calls, and the ULLS for WLR), were determined on the basis of a TSLRIC+ approach. As indicated above, the ACCC's own Access Pricing Principles Guide indicated that access prices should be based on the costs of providing the service.[53]

The ACCC has deliberately chosen pricing principles for individual services which derive the lowest price for access seekers. For example, in deciding an RMRC approach for the LCS, the ACCC conceded that the costs of the local call exceeded the regulated retail price cap of 20 cents/call:

> *"The ACCC's approach to determining the LCS access price in this Final Determination is based on pricing principles adopted previously which specify use of a retail-minus retail costs methodology. This reflects the ACCC's view that the TSLRIC on a local call, including indirect costs and an ADC (i.e. TSLRIC++), plus retail costs is likely to exceed the price-capped retail price of 20 cents, at least for the 2002-03 and possibly the 2003-04 financial year."*[54]

Rather than set an access price that reflected the cost of providing the service, and which was consistent with the approach it had taken to determine the regulated access price of other declared services, the ACCC chose a retail-minus retail costs (RMRC) pricing approach that would leave Telstra, as the main provider of the service at the time, bearing all of the costs of providing the service, while allowing access seekers to acquire the service at a below-cost regulated price.

The ACCC has more recently reiterated its view that it will select the pricing approach which results in lower regulated prices for access seekers:

> *"If costs are below the RMRC access price for the service, then a cost-based approach would be more likely to be reasonable. If RMRC access prices are below costs, then a RMRC approach would be more likely to be reasonable."*[55]

The ACCC is now investigating whether it should re-determine regulated pricing for the two services, on the basis that of its view that the TSLRIC+ of providing the services is likely to now be below the RMRC prices[56].

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[51] ACCC, *Declaration of Local Telecommunication Services – A Report on the Declaration of an unconditioned local loop service, local PSTN originating and terminating services, and a local carriage service under Part XIC of the Trade Practices Act,* July 1999.

[52] Ibid, at p105.

[53] ACCC, *Access Pricing Principles: Telecommunications – A Guide (Access Pricing Principles),* July 1997.

[54] ACCC, *Final Determination for Model Price Terms and Conditions of the PSTN, ULLS and LCS Services,* October 2003, at p6.

[55] ACCC, *Pricing Principles and Indicative Prices- Local Carriage Service, Wholesale Line Rental and PSTN Originating and Terminating Access Services, Final Determination and Explanatory Statement,* 29 November 2006, at p9.

Example 7 – ULLS pricing

The ACCC's assessment of the TSLRIC of ULLS in Band 2 has declined from $35 per month in March 2002 to $12.30 by July 2006, despite the prices of key inputs – labour, fuel and copper – increasing over that period[57].

Specifically, in March 2002 the ACCC issued its final report on the pricing of the ULLS for that year, specifying a band 2 ULLS price of just over $35 per month. Then in October 2003, the ACCC issued its ULLS model terms and conditions which included pricing of the ULLS at $22 per month in band 2, with a volume adjustment mechanism to address uncertainty of demand. Telstra then lodged revised ULLS undertakings at the ACCC's prices, with the volume adjustment mechanism. Even though they reflected the ACCC's model terms and conditions, the ACCC issued a final decision to reject Telstra's undertakings in December 2005. The new band 2 ULLS price implied in the ACCC's final report was $13 per month. The ACCC has subsequently issued interim determinations, draft final determinations and indicative prices in the $12.30 - $16 per month range[58].

This highlights two factors contributing to the uncertainty that faces investors and potential investors in access networks:

- *An absence of guidance* – despite the title, the indicative prices set by the ACCC are not to be taken as indicative of the prices the ACCC would accept in an undertaking; and

- *Variability* – the ACCC's assessment of TSLRIC+ of ULLS in band 2 varied (downwards) by 65% from March 2002 to December 2006.

In support of its most recent ULLS undertaking lodged in March 2008, and on the basis of the ACCC's long-stated reliance upon TSLRIC+, Telstra has invested over $2 million developing a world-leading TSLRIC+ cost model, known as the Telstra Efficient Access (TEA) model. The TEA model shows that the TSLRIC+ of ULLS in band 2 is approximately $47 per month. However, Telstra's undertaking proposed a price of $30 per month as an appropriate step toward cost recovery for this service.

In its draft decision to reject Telstra's undertaking based on the TEA model, the ACCC went to great lengths to explain that TSLRIC+ may not be consistent with the legislative criteria; rather that it relies on 'various information' to set access prices:

> *"for example, comparing the proposed price term with the access provider's internal transfer price, with the retail price, with other international benchmarking prices. Cost model estimates are another source of information that has been useful in assessing the reasonableness of price terms in an undertaking."*[59]

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[56] Ibid, p9.
[57] Between July 2002 and July 2006 copper prices increased by 386%, fuel increased by nearly 182% and labour costs increased by 14%.
[58] June 2008 draft final determinations applied $12.30 for Band 2 for 2005-06; June 2008 indicative prices $14.30 for 2007/08 and $16 for 2008/09.
[59] ACCC, *Assessment of Telstra's Unconditioned Local Loop Service Band 2 monthly charge undertaking, Draft Decision*, November 2008, page 33

A surprising inclusion is the weight afforded to international benchmarking – that is the pricing determined by regulators in overseas markets, presumably by reference to cost models which the ACCC has not scrutinised and unspecified other considerations.[60] This seems incongruous in the face of a comprehensive and transparent TSLRIC+ model for the service in Australia, which has been reviewed by international experts.

The ACCC goes on to contemplate replacing the TSLRIC+ cost standard for ULLS pricing with a jumble of approaches – prices that reflect replacement costs for some elements of the service and historical or embedded costs for others.[61] It then sums estimates for individual elements derived, expressly by using the lower of the differing costing approaches, to derive the lowest possible access price. This approach is inconsistent with cost recovery, with the ACCC's own pricing principles, with the use of TSLRIC+ as endorsed by the Tribunal and with any conceivable market outcome.

In defending this 'mix and match' approach, the ACCC suggests that it is no different from using TSLRIC+ in respect of some declared services while using RMAC for others.[62] Even setting aside Telstra's opposition to this inconsistency on the grounds that it does not assure cost recovery, the comparison the ACCC draws is flawed. It is one thing to cost an entire service on an RMAC, TSLRIC+ or other basis. It is quite a different thing to price a single service using a mix of the lower of historical cost or replacement cost for inputs.

The substitutions the ACCC proposes, although they are inconsistent in application from case to case and time to time, appear by no means random. Rather, they culminate in a model that yields the lowest estimate of total costs. No economic meaning, nor any normative significance, can be attached to a cost estimate that is derived in this way. Its sole 'virtue', if it can be called that, is that it leads to a lower, albeit entirely arbitrary, number.

Such an approach abandons any economic rigor for the sake of minimising the cost estimate. It is no different from the approach the Tribunal quite properly rejected when, in *East Australian Pipeline Limited*, it criticised the ACCC for putting "recognised valuation methods to…one side, [in] *departing from a quest for value and entering upon a quest for some form of justice or equity*".[63] The Tribunal has also rejected, in the past, the ACCC's decisions with respect to cost methodology which arbitrarily relied upon the lowest of a plausible range of estimates, as exposing regulated businesses to unjustified asymmetric risks.[64]

Clearly, the ACCC's 'mix and match' approach cannot result in expected

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60 Ingenious Consulting Network, *Commentary on the use of International Benchmarking in Setting Interconnection Rates*, December 2008.
61 As one example, the ACCC requires input prices for plant and equipment to be efficient and forward-looking (ACCC Draft Decision, page 76), but that trenching costs be based on actual costs incurred (ACCC Draft Decision, page 80).
62 ACCC Draft Decision, pages 34-35
63 *Application by East Australian Pipeline Limited* (2004) ATPR ¶42-006 at 48,804 [19], emphasis added.
64 *Re Epic Energy South Australia Pty Ltd* [2003] ACompt 5 [90-95].
65 The ACCC's pricing for ULLS in the past has delivered low ULLS prices on the regulatory promise that the network cost component of ULLS prices will increase 50% in 9 years, over 100% in 15 years and 200% 23 years. See Schnittger, Sabine, 'Tilting the annuity: the widening gap between theory and reality', *Communications Day*, 16 February 2009, page 5.

cost recovery. This is plainly the case if the choice of which costing basis to apply to each element is made with the sole purpose of reducing the estimated total.

Further, by means of a 'tilted annuity', the ACCC has continued to purport to shift depreciation costs from the current regulatory period to periods far in the future. In doing so it implicitly assumes that dependent markets in the future will be able to sustain vastly increased access prices, without any sign that it can credibly commit to the prices that would need to be charged in those periods.[65] This implausible assumption is inconsistent with cost recovery, and further exacerbates the risk faced by an access infrastructure owner.

Similarly, in November 2008, the ACCC also announced that in respect of the regulated Mobile Terminating Access Service (MTAS) it was no longer proposing to drive regulated prices towards TSLRIC+, notwithstanding that the ACCC had spent considerable time developing a cost model to determine the TSLRIC+ of the service[66]. See Example 8.

Example 8 – MTAS pricing principles

In November 2008, the ACCC issued draft pricing principles for the declared Mobile Terminating Access Service[67] (the Draft MTAS Determination). In the Draft MTAS Determination, the ACCC adopted a different approach to determining the pricing for the MTAS than that established through the body of precedent built up over the years in relation to the pricing of the MTAS, including statements by the Tribunal adopting the TSLRIC+ principle.

Rather than adhering to TSLRIC+, the ACCC is now saying that efficient operators may be able to price somewhat above their costs[68] and that consequently, the TSLRIC+ approach as demonstrated by the ACCC-commissioned cost model on which the industry consulted, should now be taken as a floor on the costs of providing the service.[69]

This is completely contrary to the pricing principles adopted by the ACCC in numerous decisions over the last four years in relation to the appropriate price of the MTAS, including those set out below.

In 2004, the ACCC determined a downward glidepath for the MTAS pricing, with the aim of reducing MTAS prices towards costs.[70]

In early 2006, the ACCC rejected undertakings by Optus and Vodafone on the grounds that the pricing sought was higher than the ACCC's then estimate of a TSLRIC+ methodology:

> *".. the ACCC has concerns with some of the methodological and conceptual decisions made by Optus is [sic] determining its FL-LRIC++ principle. As a result of these concerns, the ACCC*

[66] ACCC, Draft MTAS Pricing Principles Determination and indicative prices for the period 1 January 2009 to 31 December 2011, November 2008.
[67] ACCC, *Draft Pricing Principles determination and Draft Indicative Prices for the Declared Mobile Terminating Access Service,* November 2008.
[68] Draft Determination, page 11.
[69] Ibid, page 15.
[70] ACCC, MTAS Mobile Services Review Mobile Terminating Access Service, Final Decision, June 2004, at p211

believes that it would be more appropriate to set a target price for the MTAS on the basis of a TSLRIC+ methodology rather than the FL-LRIC++ methodology proposed by Optus."[71]

".. the ACCC considers that there is no certainty that cost estimates based on Vodafone's network will reflect an appropriate forward-looking cost estimate of an 'efficient operator' supplying the MTAS."[72]

In the Vodafone decision, the ACCC rejected the cost model developed by Vodafone's consultant, because the ACCC considered that it would likely overstate the MTAS costs of an efficient operator in Australia:

"The reasons for the ACCC reaching this view are that:

- *the use of a top-down FAC modelling approach based on Vodafone's data is likely to tend toward overstating the 'forward-looking efficient economic costs' of providing the MTAS. This is due to the conceptual and practical differences between a FAC model and a TSLRIC+ model, and also due to the tendency for top-down models to generate, at best, an upper bound on the efficient costs of service provision;*
- *the most appropriate benchmark for modelling 'forward-looking efficient MTAS cost is that of an 'efficient operator'."*[73]

Similarly, in issuing its final decision on Optus' 2007 Undertaking, the ACCC said:

"The ACCC is not satisfied that accepting the Optus 2007 Undertaking will be likely to promote the LTIE. This is because the Optus 2007 Undertaking would establish a price structure for the MTAS in excess of an estimate of the TSLRIC+ relevant for the period 1 July 2007 to 31 December 2007."[74]

And in November 2007, only 13 months ago:

"Throughout three years of consultation, analysis and review of these models the ACCC's position on cost models has been well documented, widely publicised and affirmed by decisions of the Tribunal. For example, in its Vodafone decision the Tribunal indicated that while cost models distinct from TSLRIC+ models are not unreasonable, it is generally not in the LTIE to depart from TSLRIC pricing for regulated access services and that access prices should reflect and not exceed forward-looking efficient costs."[75]

"… the ACCC's approach to access pricing has been considered by the Tribunal. Key areas affirmed by the Tribunal include the:
- Appropriateness of a bottom-up TSLRIC framework for efficient cost-based pricing for the MTAS."[76]

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[71] ACCC, Optus' Undertaking with Respect to the Supply of its Domestic GSM Terminating Access Service (DGTAS), Final Decision, February 2006, at p xvii
[72] ACCC, Assessment of Vodafone's Mobile Terminating Access Service (MTAS) Undertaking, Final Decision, March 2006, at p35.
[73] Ibid, pp43-44.
[74] ACCC, The Optus 2007 Undertaking in relation to the Domestic Mobile Terminating Access Service Public Version, Final Decision, November 2007, at p 27.
[75] ACCC, MTAS Pricing Principles Determination 1 July 2007 to 31 December 2008, p20
[76] Ibid, at p8.
[77] Ibid, at p48
[78] Draft Determination, p12.
[79] Draft Determination, page 11.
[80] Application by Vodafone Network Pty Ltd & Vodafone Australia Limited [2007] ACompT 1 (11 January 2007) at [44].

"Regardless of the network design, the value of that network should reflect an access price which reflects or is tending toward an efficient cost for the supply of the relevant access services using that network (and in the case of MTAS using a TSLRIC+ estimate). There is also recognition that pricing aligned to efficient costs will more likely encourage efficient investment in infrastructure."[77]

In its Draft MTAS Determination of November 2008, the ACCC again acknowledged that TSLRIC+ is consistent with the legislative criteria set out in Part XIC[78], but then inexplicably departs from this approach. The ACCC has not attempted to justify why the alternative approaches canvassed in the Draft Determination are sufficient to satisfy the legislative criteria, nor indeed, why the other factors it considers are so compelling as to override the approach that the ACCC has said on numerous occasions does meet the legislative criteria.

Instead, the ACCC's pricing principles now say that while TSLRIC+ remains an "appropriate consideration", it can consider other methods in determining indicative pricing for the MTAS. The ACCC then indicates that the appropriate price for the MTAS should be some 3 cents/minute higher than the ACCC's TSLRIC+ estimates, the ACCC weighed the following three factors to derive a price of 9cpm for the period from 1 January 2009 until 31 December 2011:

- the efficient costs (TSLRIC +) of providing the MTAS is between 5.8 and 6.1cpm;
- a cursory look at international benchmarking shows that as at 1 July 2008, the average MTAS price of five European countries was 14.6cpm; and
- the ACCC's concern that Telstra's retail fixed to mobile prices might not be as low as it claims they should be.

Thus, as with ULLS, the ACCC's MTAS pricing principles mark a stark move away from a predictable, principled approach implemented over the last four years, to one that is vague and gives the industry no certainty as to what price might be determined by the ACCC in any given instance. Nor does it allow a provider of the regulated MTAS any firm basis upon which to put a case to the ACCC as to what the regulated price should be, and to know with any certainty whether that price might be accepted. This cannot be in the long-term interests of end-users. This cannot satisfy the legislative criteria. This cannot encourage investment in this industry.

In adopting a price above its estimate of TSLRIC+ for the MTAS, the ACCC takes the view that "costs incurred in a competitive market may be efficient, even if above the cost estimated using a pure TSLRIC approach".[79] This approach, however, does not accord with the observations of the Australian Competition Tribunal which only recently said that:[80]

> *"… it would generally not be in the long-term interests of end-users to depart from TSLRIC pricing where access is regulated. However, we would repeat the observation of the Tribunal in Telstra Corporation Limited (supra) at par [63]:*
>
> > *"In this area of analysis there is no one correct or appropriate figure in determining reasonable costs or a reasonable charge. Matters and issues of judgment and degree are involved at various levels of the analysis."*
>
> *Nevertheless, we still consider that in general terms the prices in access undertakings should reflect and not exceed forward looking efficient economic costs: Telstra Corporation Limited (supra) at par [46]."*

This decision was followed in February 2009 by the ACCC's draft decision on the pricing principles for the declared wholesale transmission service, where the ACCC expressed the view that transmission prices could continue to be based on the TSLRIC of providing the service, because it:

> *"considers that prices set in this fashion are consistent with those that would prevail if the access provider faced effective competition."*[81]

The ACCC then explains how prices based on TSLRIC meet the legislative criteria[82].

Telstra submits that it is impossible for an impartial observer to view these various decisions with their inconsistent positions (both between services and within a service over time) and in any way conclude that this is a regime that meets global best practice in terms of certainty, predictability and ensuring that efficient cost recovery principles are met.

(iii) Costs of the service are not borne by the users of the service

The discretion afforded under Part XIC has allowed the ACCC to reduce access prices even further by purporting to share the costs of providing access services across a broader customer base than those customers accessing the service. So rather than adopting a 'user pays' principle, the ACCC has instead required Telstra to distribute the costs of providing the wholesale access service to access seekers across its wholesale and retail customer base – see Example 9. The result is to force customers who do not use the service to cover its costs.

Example 9 – LSS and ULLS specific costs

Telstra is required to supply access seekers with the regulated Unconditioned Local Loop Service (ULLS) and the regulated Line Sharing Service (LSS). In providing each regulated service, Telstra necessarily incurs costs that relate solely to the provision of that service to its customers. These services (or "service specific costs") include the costs associated with ordering, provisioning and qualifying the service.[83] Yet in developing its pricing principles for the ULLS (which is mirrored for the LSS), the ACCC pools those costs with Telstra's own internal costs, and then allocates them across all ULLS, LSS and even Telstra's wholesale and retail ADSL lines, thereby distributing the costs across a much broader cost base:

> *"The ACCC considers that the ULLS specific costs should not be recovered from ULLS lines alone.*
> *…*
> *'ULLS specific costs' should be combined with 'LSS-specific costs' and 'Telstra's internal equivalent costs when providing internal line-sharing' and allocated across the active number of ULLS, LSS and ADSL lines. This approach has been referred to as the "pooling approach" or the "broad recovery base approach".*[84]

It is apparent, therefore, that the telecommunications industry needs just not a guarantee of cost recover in providing services to access seekers: it

[81] ACCC, Domestic Transmission Capacity Service, An ACCC Draft Report on Reviewing the Declaration of the domestic Transmission Capacity Service, February 2009, at p32.
[82] Ibid.
[83] ACCC, Unconditioned Local Loop Pricing Principles and Indicative Prices, June 2008, at p12.
[84] Ibid. pp13-14

also needs the principle of "users pays", so that Telstra is able to recover the costs it incurs in providing wholesale services to access seekers, from the parties who benefit from that service, rather than having to bear more of the cost itself, or to distribute the costs across its other retail and wholesale customers.

The effect is to stymie further investment in access seeker specific infrastructure. For example, one access seeker that purchases LSS/ULLS has requested that Telstra invest in a system specific to their ordering process. However, since the regulator would spread the cost of that investment over all Telstra's retail customers, the return from that investment would be a small fraction of the cost of its implementation.

Thus, even where the ACCC purports to determine an access price consistent with cost recovery, this outcome is entirely illusory due to the allocation of access-specific costs across both the retail and wholesale customer base of the access provider.

These examples highlight that the ACCC's access pricing decisions under Part XIC have been inconsistent and unpredictable in numerous respects:

- They are inconsistent over time;
- They are inconsistent as between different services that use the same infrastructure;
- They are inconsistent with the ACCC's own pricing principles which have been endorsed by the Tribunal; and
- They are inconsistent with cost recovery.

Overall, a regulatory system in which the regulator can arbitrarily choose whether to apply a cost standard, change the applicable cost standard and, worse, jumble values derived from different and inconsistent costing approaches in the attempt to minimise estimated total costs, is plainly incapable of providing regulatory certainty or promoting efficient investment.

This inconsistency in the ACCC's approach is a burden on those in the industry, as there is no certainty as to how a particular regulatory decision will be made, and therefore no certainty as to the likely outcome. It substantially increases the business risk for industry participants, as well as discouraging investment within the industry.

D.3 An absence of accountability means inconsistency goes unchecked

(i) Lack of merits review

As outlined in Section C, decisions on exemption applications and undertakings are subject to merits review, but decisions by the ACCC to declare services, issue indicative prices or model terms and make arbitral determinations are not. As a result, the ACCC's consideration of undertaking and exemption processes demonstrate a much more robust and information-intense process prior to making its decision than is evident in any declaration review, or any decision to publish indicative prices for a declared service.

This is despite the recommendation of the Taskforce "that there should be provision for merit review of any administrative decisions that can significantly affect the interests of individuals or enterprises",[85] and the then Government's agreement in principle to that recommendation.[86]

(ii) No oversight of ACCC consistency

There is no requirement that the ACCC regulate consistently (including that the decisions all 'add up'), and there is no evaluation of the impact of the inconsistencies highlighted above, including its impact on investment. This is not something that can be addressed by requiring merits review. Proper analysis of the impact of the ACCC's regulatory decisions – on market participants, markets and the economy as a whole – is required.

D.4 Procedural issues that exacerbate uncertainty

(i) Inconsistent evidentiary standard

The ACCC's and the Australian Competition Tribunal's administration of Part XIC has seen them impose an impossibly high evidentiary hurdle on proponents of access undertakings, yet a very low burden of proof is required of the ACCC's own decisions to impose regulated pricing. This inconsistency of evidentiary standard is very apparent when one compares the analysis undertaken by the ACCC in determining access prices in confidential arbitral determination to the standard it applies in assessing undertakings. It is also apparent when the ACCC's public statements on pricing principles are compared to its – and the Tribunal's – requirements for evidencing the reasonableness of an access undertaking. Examples 10 and 11 are illustrative.

> *Example 10 – Inconsistent standards for cost model transparency*
>
> Telstra has ensured that the TEA cost model is transparent and easy for interested parties to work through. This involved setting out all calculations in a language that proficient cost modellers would be expected to understand (Microsoft Excel), documenting those calculations thoroughly, and making them available to a wide range of interested parties subject to confidentiality conditions. It also involves designing the model so that it runs in an intuitive way.
>
> One ACCC model, however, fails even the most basic aspects of transparency. The ACCC's WIK model is provided to parties in a way such that all calculations are hidden. The user is only able to see the inputs that go into the model and the outputs that come out of it. All calculations are a 'black box' as far as users are concerned. Despite repeated requests for the underlying programming code, the ACCC insists that it does not own the copyright and cannot provide the code to any party.
>
> More recently, the ACCC released its fixed network cost model for consultation. The extreme complexity of the model and the requirement to run 1 or 2 ESAs at a time means that it would take months for any one person to view and understand how the model's calculations are carried out. This renders the model obscure to even experienced modellers.

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[85] Taskforce on Reducing the Regulatory Burden on Business, *Rethinking Regulation*, 7 April 2006, Recommendation 7.18, page 163

[86] *Rethinking Regulation: Australian Government's Response*, 15 August 2006, page 83. The Government did distinguish financial decisions with a significant public interest element or decisions involving extensive inquiry process as factors that may mean that merits review is not appropriate. The Government did not specify precisely why merits review may not be appropriate in these instances.

Example 11 – Inconsistent evidentiary hurdles in access pricing – international benchmarking

The ACCC has rarely accepted international benchmarking provided to it in support of an access provider's suggested price for a declared service. For example, Optus, in support of its June 2004 undertaking in relation to MTAS, submitted an international benchmarking analysis prepared by CRA based on three 'comparator' countries: Malaysia, Sweden and the UK. CRA made what it considered to be appropriate adjustments for comparator countries, being the exchange rate, cost of capital and geographic terrain/network coverage.

In rejecting Optus' international benchmarking analysis, the ACCC concluded that: [87]

> (a) *"… any analysis that attempts to adjust for factors that drive cost differences between countries should be conducted comprehensively, or not at all.*
>
> (b) *…possession of the information sufficient to make a comprehensive adjustment is tantamount to that necessary to construct a bottom-up model. In the Commission's view, use of the information for the latter purpose would be superior to using it for adjusting cost estimates from other jurisdictions…*
>
> (c) *…reference in the CRA report to the range of 'cost' estimates in international jurisdictions is both misleading and not relevant to the international benchmarking exercise it has actually undertaken to generate its proposed range ... This is because many of the estimates presented by CRA are not strictly 'cost' estimates or they include some form of 'mark-up' over cost to reflect certain factors*."

On appeal, the Tribunal took a similar approach. In *Re Optus Mobile Pty Ltd & Optus Networks Pty Ltd,*[88], it dismissed the CRA report because the figures used were an inadequate comparator for Australian conditions.[89]

The Tribunal found that in order to place any reliance on international benchmarking it would be necessary to know much more about the following:[90]

- the regulatory environment within which the international prices were determined;
- the state of the relevant markets; and
- the socio-economic environment in which the mobile services were operative.

The ACCC adopted this position in its Pricing Principles decision in 2007, where it did not rely on international benchmarking in establishing its indicative price of 9cpm, but said that there was:

> *"a need to make adjustments for all factors that influence the TSLRIC of providing the MTAS in different countries for Australia-*

[87] ACCC, *Optus' Undertaking with Respect to the Supply of its Domestic GSM Terminating Access Service (DGTAS) Final Decision*, February 2006, page 124.
[88] [2006] ACompT 8.
[89] *Re Optus Mobile Pty Ltd & Optus Networks Pty Ltd* [2006] ACompT 8, paras [292]-[296].
[90] *Re Optus Mobile Pty Ltd & Optus Networks Pty Ltd* [2006] ACompT 8, para [297].

specific factors before relying on international cost benchmarks to set indicative prices below 12cpm."[91]

Similarly, Telstra, in support of its December 2005 undertaking in relation to ULLS pricing, made a submission on international benchmarking for ULLS prices.[92] While the submission was not considered by the ACCC in its final decision, it was considered by the Tribunal on appeal against the Commission's final decision.

In proceedings before the Tribunal, the ACCC submitted that before taking into account international benchmarks, the Tribunal would have to be satisfied that, notwithstanding differences between Australia and the relevant international jurisdictions, those benchmarks were reasonable comparators. The ACCC's submissions identified the following differences in regulatory approaches as relevant:[93]

- the definition of the regulated service;
- the applicable regulatory framework;
- the geographic price structure;
- the cost of capital;
- the prescribed cost standard (if any); and
- population concentration (as opposed to population density).

The Tribunal agreed with the ACCC's submissions and found that Telstra did not provide sufficient evidence to support the use of international benchmarking. In addition, the Tribunal was not satisfied that the adjustments proposed by Telstra took into account all of the adjustments which should have been made in order for the benchmarks to be reasonable comparators.[94]

In complete contrast to the above requirements it has imposed upon access seekers, in its draft decision on the appropriate MTAS prices and pricing principles to be adopted from 1 January 2009, the ACCC proposes that international benchmarking can be a method of determining MTAS costs.[95] The ACCC then considers a study undertaken of the average termination rate amongst the "Big Five" European countries by the ERG as at 1 July 2008. The ACCC then says that the resultant international benchmark rate of 14.6cpm is one of the main factors to justify maintaining the Australian regulatory price at 9cpm for 3 years from 1 January 2009.

Yet the ACCC's international benchmarking analysis for the MTAS clearly does not meet the requirements that it, and the Tribunal, have imposed upon access providers in the past. For example:

- the ACCC gives no detailed information about the data sources for the benchmarks, including whether they are price or cost benchmarks, and there is no evidence that the nature of the regulatory framework in which the prices have been generated have been considered;

- there is no detailed explanation of how peak and off peak rates

[91] ACCC, MTAS Pricing Principles Determination 1 July 2007 to 31 December 2008, at p49.
[92] See Telstra's response to the Commission's draft decision on Telstra's ULLS monthly charge undertaking dated 23 December 2005 - ULLS price international benchmarking.
[93] Telstra Corporation Ltd (No 3) [2007] ACompT 3, at para 384.
[94] Ibid, para 385.
[95] Draft Determination, p16.
[96] ACCC, MTAS Pricing Principles Determination 1 July 2007 to 31 December 2008 Report, November 2007, pages 12-14, where the Commission highlighted limitations in comparisons with MTAS rates in a number of European countries, including the UK.
[97] ACCC, MTAS Pricing Principles Determination 1 July 2007 to 31 December 2008 Report, November 2007, page 56.

have been factored into the ERG's calculation of the average rates;

- in any event, the ACCC used European data in the ERG report that is based on mobile termination rates applicable in those countries as at 1 July 2008. How those rates can be relevant for determining MTAS rates in Australia from 1 January 2009, and three years hence, remains unanswered, particularly in circumstances where the EC is urging regulatory authorities to reduce those prices quickly towards cost;

- the ACCC has converted rates to Australian rates, but there is no accurate point in time reference as again, the European data in the ERG report is based on MTAS prices applicable as at 1 July 2008. Further, ERG has already applied a currency conversion rate (a rate not disclosed in the ERG data snapshot) to adjust the rates for those countries that do not use the Euro currency. No information has been provided about the date at which these exchange rates were applied. The ACCC has then further converted the rates into Australian dollars by applying a September 2008 exchange rate. Therefore the ACCC has not relied on any data providing an accurate single point in time comparison of the relevant prices;

- The ACCC gave no justification for relying on what it refers to as the "big 5" European countries as the most appropriate comparisons for the purposes of the benchmarking of MTAS rates, The ACCC has previously found the approach taken to setting termination prices in countries such as the United Kingdom need to be carefully scrutinised before being compared with the Australian regulatory context because it should not be assumed that rates set by other national regulatory authorities serve the same objectives as set out in the relevant Australian legislative criteria;[96] and

- The ACCC has previously noted the EU Commission's own concerns about the role that inflated 3G spectrum costs may play in the costs of providing mobile termination in Europe. In the 2007 MTAS Pricing Principles Determination the ACCC referred to the fact that, on average, the impact of 3G spectrum costs added the equivalent of 2.9 to 4.5 Australian cents per minute to MTAS prices at the time.[97] A proper assessment of European benchmarks for MTAS would need to re-assess and adjust prices to take these inflated European spectrum costs into account prior to making any comparison with Australian rates.

The telecommunications regulatory regime does not seem to require a consistent approach by the regulator in determining the appropriate regulated price for a declared service: it seems as though the ACCC can create one rule for an access provider seeking to establish its price as reasonable, and then adopt a much more relaxed approach to the same issue, even ignoring its own previously-established requirements, when the ACCC itself is seeking to support its own view of pricing.

(ii) Undertaking process set up to fail

Since the introduction of Part XIC in 1997, the ACCC has accepted five undertakings of the 26 submitted by Telstra, Optus, Vodafone and FOXTEL. The legislative intent was that the undertakings mechanism – which would efficiently establish default industry-wide terms and conditions rather than require multiple bilateral arbitrations – would be the preferred mechanism to determine terms where commercial negotiations failed. The retention of merits review of decisions on undertakings reflected this.[98]

But it is simply too difficult to have an undertaking accepted as reasonable, in circumstances where the absence of merits review means the ACCC is much less accountable for arbitral determinations. The fundamental problem is that Part XIC requires the ACCC **not** to accept an undertaking unless it is satisfied that undertaking is reasonable. This has been interpreted to mean:

- first, that the burden of meeting any doubts or responding to any criticisms rests with the access provider, regardless of whether those doubts are substantial or even substantiated;
- second, that to be satisfied that the prices set out in an undertaking are reasonable, each element that has gone into the calculation of those charges must be reasonable; and
- third, that, in the event of an appeal, the material Telstra has put on prior to the ACCC decision must be capable of dealing with any issue that may arise in the appeal, even if not raised initially.

Further, even if the ACCC requires only minimal changes to enable it to accept the undertaking, there is no mechanism to revise undertakings – the whole consultation process must be repeated. This stands in marked contrast to the digital radio multiplexer access regime (Example 12) which provides a mechanism for revision of an undertaking that is rejected.

> *Example 12 – Digital radio multiplexer access regime*
>
> The access regime for digital radio multiplexers provides for the ACCC to issue a notice setting out the changes required to achieve acceptance of a rejected undertaking. Section 118NF(4) of the Radiocommunications Act 1992 provides as follows:
>
> If the ACCC rejects the access undertaking, the ACCC may give the licensee a written notice advising the licensee that, if the licensee:
> (a) makes such alterations to the access undertaking as are specified in the notice; and
> (b) gives the altered access undertaking to the ACCC within the time limit allowed by the Procedural rules;
> the ACCC will accept the altered access undertaking.

Part XIC does not even require the ACCC or the Australian Competition Tribunal to determine all issues in relation to the undertaking, to give parties the benefit of knowing the ACCC's/Tribunal's views on the issues. If a single element of an undertaking is found to be unreasonable, the whole undertaking can be rejected without any consideration of the other elements.

(iii) Commercial negotiations overhung and undermined by regulation

The legislative intent of the telecommunications access regime was that the terms of access would primarily be the result of commercial processes and industry self regulation, with arbitration available if negotiations were unsuccessful[99]. The fact is that the prospect of regulatory intervention overhangs negotiations regarding regulated services, to the extent that agreement is impossible at anything other than regulated terms. The reason for this includes the ACCC's broad powers to publish indicative prices for declared services, without full inquiry, which set

[98] Telecommunications Competition Bill 2002 Second Reading Speech, p.3
[99] Trade Practices Amendment (Telecommunications) Bill 1996 p.3

industry expectations on the prices that might be achievable before the regulator. There is no obligation upon the ACCC to then adopt its indicative prices in an arbitration, and to the extent that it has substantially departed from its published prices, it has generally done so in favour of the access seeker[100], providing a further encouragement for access seekers to choose a regulatory outcome over a commercially negotiated one. The ACCC is also given the express power to make interim determinations in the course of an arbitration based on little evidence, and then to publish that determination to the rest of the industry – sending a clear message to the industry of the outcomes likely achievable before the regulator.

The threshold for the ACCC to accept a dispute for arbitration is low – simply that the parties are 'unable to agree'. The ACCC has advised that it will entertain arbitrations even in circumstances where there is a written contract between the parties for the terms of supply of the service, and when the access-seeker attempts to vary the terms, and the access provider does not agree. This again has the effect of overriding commercial outcomes.

In addition to the above examples of publishing indicative and interim prices for declared services which may or may not reflect final regulated pricing, the ACCC has gone further, and published the output of a cost model it has developed, when that cost model is in its preliminary stages only, and when the ACCC at the same time is requesting the industry to provide a list of errors found in the model. See Example 13.

Example 13 – ACCC release of Analysis fixed network cost model

In December 2008 the ACCC issued a discussion paper and its consultant-developed TSLRIC cost model for the fixed telecommunications network. In its discussion paper, the Commission published the prices generated by the model. It did so, despite the following:

- The Commission's discussion paper invites parties to notify the Commission of errors in the model (and contains a suggested template for listing errors found).
- The discussion paper also invites comments on the appropriateness or otherwise of the construct of the model, and the various inputs used in it.
- The Commission has made no decision as to what inputs to the model are appropriate nor what the regulated prices should be – the inputs used in the cost model are those of the ACCC's consultant.
- The Commission is well aware of the potential for any prices it publishes to set expectations in the industry of likely regulated pricing.

At the date of writing, Telstra is still examining the cost model. However, it is clear from an initial review that there are many fundamental issues with the model that have the potential to significantly alter the ultimate price generated for the declared services. For example, the weighted average cost of capital (WACC) is the lowest ever used by the ACCC in this industry (illogical in light of the global financial crisis) and the model significantly understates distances and quantities of copper (and therefore substantially understates the availability of services such as the ULLS, thereby understating its cost).

By publishing the preliminary outputs of the draft cost model, the Commission has inappropriately sought to set industry expectations around pricing levels that simply have no basis, and has sought to

[100] See for example, the significant reduction in the ACCC's pricing for the ULLS, between its published view of indicative pricing, and the price finally determined in arbitrations for 2006, as mentioned above in Example 7.

undermine commercial negotiations, to which Part XIC affords precedence, with outputs from an unreviewed and untested cost model.

Nor are the ACCC's attempts to overhang commercial negotiations with its views on appropriate terms of supply are limited to pricing – see Example 14.

Example 14 - Model Non-Price Terms & Conditions Determination

The Model Non-Price Terms & Conditions Determination 2008 identifies the ACCC's views about the model non-price terms that should apply for the supply of core regulated services such as the ULLS, PSTN OTA and LCS. While it is non-binding, the publication of the Model Terms naturally sets industry expectations regarding what the regulator is likely to decide in any dispute between parties in the industry, thereby potentially undermining commercial arrangements that currently apply, and overshadowing any negotiations. If implemented the Model Terms would burden the industry with additional costs, yet the ACCC has not undertaken any proper cost/benefit analysis.

The unfunded new processes which the Model Terms seek to require include:

- Telstra must give access seekers detailed information about the nature, timing and impact of any "Major Network Modernisation and Upgrade", and to consult and negotiate with access seekers before proceeding (Clauses G.1, G.2);
- The requirement for Telstra to provide a Line Sharing Service (LSS) to ULLS migration process (J.18, J.19);
- The requirement for Telstra to provide an ordering and provisioning process for inplace ULLS (J.20-J.24);
- The requirement for Telstra to provide a "Connect Outstanding" process for ULLS (J.25, J.26); and
- A detailed and onerous regime of inquiries, considerations and information provision attaching to Telstra's decisions about access seekers' access to exchange buildings (K.1-K.26).

In addition to ignoring how the costs of providing these processes should be recovered, the ACCC has not demonstrated that sufficient demand for these processes exists to justify any investment in developing them. In fact, industry had separately explored the development of a LSS to ULLS migration process through its self-regulatory body, Communications Alliance (CA). CA undertook a costs assessment and considered the likely demand for this process, and concluded (after consultation with access seekers as well as Telstra) that its development would be uneconomical, as the likely indications were that there would be insufficient demand to justify the costs involved in developing the process. Clearly dissatisfied with this outcome, the ACCC has sought to impose the process without undertaking any costs assessment.

D.5 The exemption regime does not work to provide the required certainty

In 2001 the Government sought to improve the investment climate in the telecommunications sector by establishing the anticipatory undertaking and exemption mechanisms. The mechanisms ostensibly allow parties to get up-front certainty as to the extent and terms and conditions of any access regulation before investing.

However, these mechanisms have a series of technical flaws which have prevented them from ever being successfully used:

- To obtain an exemption, the services to be exempt must be specified up front. This requirement is unworkable. Carriers make investments in *networks*, the *services* over which can only be partially described in advance.

- Once an access exemption is granted the ACCC may unilaterally vary or revoke that exemption if it believes there has been a material change of circumstances. This makes the grant of an exemption largely worthless.

- A decision to accept or reject an anticipatory exemption application is appealable to the ACT by competitors.

    - The one appeal – by Seven Network against anticipatory exemptions granted to Telstra and FOXTEL for the investment in digitising Telstra's HFC cable network and rolling out digital FOXTEL set-top boxes – was successful. The Tribunal found that, contrary to the assertions of Telstra and FOXTEL and the finding of the ACCC, digitisation would have proceeded whether or not the exemption was granted. Thus the key argument of the investors – that the exemption was in the long-term interests of end users because it would afford the benefits of digitisation – was rejected, on the grounds that the parties faced an imperative to digitise and FOXTEL had in effect announced its intention to digitise.[101]

    - The implication of this decision is that a party must freeze an investment until the decision to grant an exemption has been made and any appeal has been exhausted. If the investment is imperative or otherwise attractive, an exemption application may be rejected on the grounds that the investment is likely to occur without an exemption. Perversely, unattractive investments would be more likely to secure the protection of a Part XIC exemption.

In summary, the anticipatory exemption mechanism is not capable of providing regulatory certainty in any timely or meaningful sense.

D.6 Impact on investment

A regulatory system in which the regulator can arbitrarily elect whether to use a cost standard, change the applicable cost standard and, worse, jumble values derived from different and inconsistent regulated pricing methodologies in an apparent attempt to minimise estimated total costs, is plainly incapable of providing regulatory certainty or promoting efficient investment.

The combined effect of the features of Part XIC and its implementation as described above are that access providers have no certainty as to what the regulated terms will be. What they do know is that they are at considerable risk of regulatory opportunism which sees access seekers (who are often also their competitors) enjoying access prices at below cost and return on investment pared back accordingly.

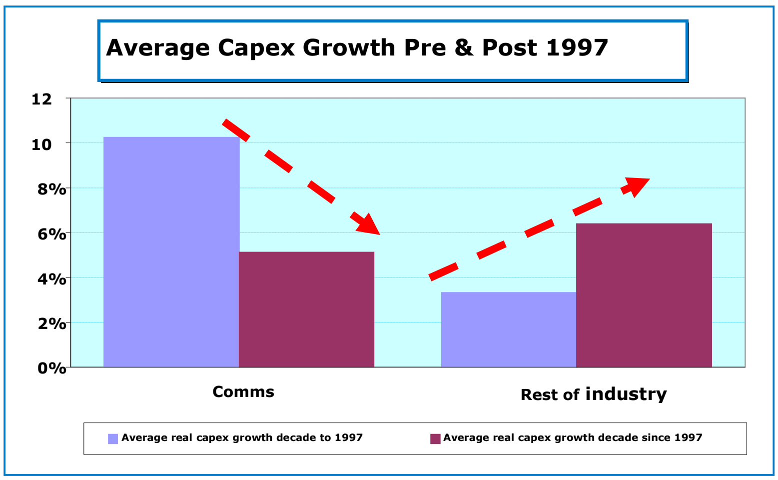
[101] Re Seven Network No.4 [2004] A CompT 11 at para 196ff.

The conclusion that investment will be stifled in a regulatory regime such as the one described above is supported by empirical evidence.

Figure 3 compares the long-term CAPEX growth rates in the decade prior to 1997 with the following decade, in the Australian communications sector and the rest of industry[102]:

1. Historically CAPEX growth in Australia's communications sector has significantly out-performed CAPEX growth in other industries. Specifically, in the decade prior to 1997, average annual growth in the communications CAPEX averaged 10.2%. By comparison growth in CAPEX in non-communications sectors grew at approximately 3.3%.
2. Since the introduction of open competition in the telecommunications sector (i.e. between 1997 and 2006), facilitated by the Part XIC access regime, there has been a significant period of under-performance. Since 1997, annual growth in CAPEX averaged 5.1% in the communications sector compared with 6.4% growth for other sectors.

Figure 3



The Australian communications sector was one of few where CAPEX growth in the decade since 1997 was slower than in the decade prior to 1997.

In addition there is conclusive anecdotal evidence of the fact that investment is being stifled by regulation. The Government's NBN Request for Proposals was necessary because investment in the NBN was not forthcoming without regulatory certainty, which the existing regulatory regime was widely acknowledged to be incapable of providing. See Example 15.

> *Example 15 – NBN RFP*
>
> In April 2008 the Minister for Broadband, Communications and the Digital Economy issued a Request for Proposals to roll out a high-speed, fibre-based broadband network.

[102] When looking at investment trends in the telecommunications sector long-term analysis is superior to short-term analysis because:

- investment incentives operate with a time lag;
- CAPEX in telecommunications sector is lumpy and cyclical; and
- technology advance is often a driver of short term investment, often in unregulated assets.

The RFP calls for proponents to:

> "provide a detailed description of, and justification for, any proposed changes (including their duration and any mechanism for regulatory review) to existing telecommunications legislation or other regulatory measures considered necessary to facilitate the roll-out of the NBN infrastructure, to provide regulatory certainty and to enable a return on investment in the network infrastructure.[103]"

This alone is clear evidence that private investment in a high-speed broadband network is not forthcoming under the current regulatory framework in telecommunications, and that the Government concedes regulatory uncertainty and insufficient expected returns on investment – both products of the regime – are barriers to investment.

That this is the case is further borne out by the history. Since 2005 Telstra has indicated its willingness to roll out a national high-speed broadband network, as the timeline in Figure 4 illustrates. From 2005 to 2007 Telstra sought to negotiate twice with Government and once with the ACCC, the terms, including an open access regulatory framework that would afford sufficient regulatory certainty, on which it would be in the interest of Telstra's shareholders to invest in a high-speed fibre-based broadband network.

In addition, the G9 also sought to gain ACCC approval of a high-speed broadband network Special Access Undertaking in May 2007, but the ACCC rejected the G9's undertaking for reasons including, in effect, that it gave the G9 investors too much, and consequently the ACCC too little, discretion to adjust prices over time[104].

Figure 4

Timeline

- *September 2005* – Telstra proposes NBP #1 to Coalition Government but is rebuffed
- *April – August 2006* – Telstra negotiates with the ACCC on NBP #2 but is unable to gain agreement
- *February 2007* – Telstra launches Broadband Australia Campaign
- *March – April 2007* – Telstra negotiates NBP #3 with Minister (agrees) but Government will not proceed without *ACCC* endorsement (withheld)
- *May 2007* – G9 lodges special access undertaking with ACCC
- *November 2007* – Labor Government elected with National Broadband Network one of top five priorities for the first year
- *December 2007* – ACCC issues draft decision to reject G9 undertaking
- *April 2008* – Government issues NBN RFP
- *June 2008* – regulatory submissions on NBN lodged
- *August 2008* – deadline for submission of RFP responses is announced
- *November 2008* – Telstra and five other bidders lodge RFP responses

[103] Department of Broadband, Communications and the Digital Economy, Request for Proposals to Roll Out and Operate a National Broadband Network for Australia, 11 April 2008, Page 28
[104] ACCC, *Assessment of FANOC's special access undertaking in relation to the Broadband Access Service – Draft Decision*, December 2007, pp.98-99

The ACCC has stated on numerous occasions since 1997 that regulation that encourages competitors to invest in their own infrastructure is likely to best promote the Long Term Interests of End Users and that:

> *"[f]acilities-based competition is more likely to lead to sustainable competition, spur dynamic innovation and encourage the diffusion of new technologies over time; ultimately providing greater prospects for the relaxation or removal of access regulation".*[105]

Despite its stated adherence to these policy goals and market outcomes, it is apparent the telecommunications access regime under Part XIC and the ACCC's administration of that regime has failed in meeting these objectives.

Rather than promoting efficient, facilities-based competition; the Commission's application of Part XIC has entrenched reliance on Telstra's network – even in the presence of multiple alternative networks. The most egregious example of this failure is SingTel Optus' decision not to invest in upgrading its own Hybrid-Fibre Cable (HFC) access network, instead relying on regulated low cost access to Telstra network services. See Example 16.

Example 16 – Optus HFC

SingTel Optus' HFC network passes 2.2 million premises in the metropolitan areas of Sydney, Melbourne and Brisbane. The network was completed in 1997 and is capable of providing 'triple-play' services of voice telephony, broadband internet and video (pay-tv) services.

Although the SingTel Optus HFC network was designed to compete with (and is in many ways technically superior to) Telstra's PSTN, it has remained stagnant and forgotten as SingTel Optus has increasingly favoured the cheap, regulated access to the Telstra PSTN provided to it by the ACCC. Since 2000, SingTel has elected to use regulated access to LCS/WLR resale services and (increasingly since 2004) ULLS within the geographic areas where the SingTel Optus HFC network has been rolled out. Given the availability of and its reliance on regulated access SingTel Optus has forsaken the expansion, investment or upgrade of its own HFC network, as would otherwise have occurred within a context of full facilities based competition. The ACCC's application of regulated access under Part XIC operating as an effective road block to this full facilities based competition.

As a result, SingTel Optus has not invested to keep its network up-to-date, highlighted by the fact SingTel Optus uniquely amongst major cable operators continues to use 1990s cable telephones technology with no commitment to upgrading. This reflects the disincentive effects on investment of the current regulatory environment – it is much cheaper to access below-cost, regulated services available from Telstra's network, than to invest in one's own existing infrastructure. Further, SingTel counts only 1.4 million of these premises as serviceable – a percentage of only 64%, compared to 97% serviceable figure for the Telstra HFC, which is comparable to serviceability figures for overseas cable network operators such as Virgin Media (94% of homes passed treated as serviceable), the Rogers HFC network in Canada (97%) and the UPC network in the Netherlands (96%).

In order to attempt to rectify the failure of the regulatory regime to

[105] Refer, for example, ACCC Fixed Services Review, Second Position Paper, April 2007 at p21

promote investment and deliver the multi-faceted benefits of full facilities based competition Telstra sought (in an application for exemption lodged in December 2007) the withdrawal of regulated access to ULLS and other regulated access services for SingTel Optus in those areas in which SingTel Optus' HFC own HFC network has been deployed.

In rejecting Telstra's application for exemption in a decision made in November 2008, the ACCC effectively stated that granting the exemption would not result in SingTel Optus being a more effective competitor because it is not "economically feasible" for SingTel Optus to connect premises it currently treats as unserviceable by HFC within its footprint.

The ACCC's decision to reject Telstra's exemption application is against international regulatory best-practice and discredits its prior proclamations that it favours and seeks to encourage, facilities-based competition. Had the exemption been granted, this would have likely been the spark which triggered the intense cable vs. copper competition, evident in other parts of the world, which Australian consumers are missing out on. If SingTel Optus could no longer dual source HFC and ULLS to connect customers, it would no longer have an incentive to hold back the speeds achievable on its HFC network. If SingTel Optus invested in its HFC and opened a speed gap over current services on Telstra's network, other competitors will have to respond by investing, innovating or reducing prices for current slower speed products. Customers would benefit across the HFC footprint from more intense competition, whether or not they could directly connect to the SingTel Optus HFC network.

Removing SingTel Optus' regulated access to ULLS in its HFC network areas, would remove its incentive to stop investing in its HFC and to hold back the speeds achievable on its HFC network to the same level as its DSLAM infrastructure. which it does this currently to give itself a dual sourcing option. It also would have an incentive to move on from the 1990s era telephony technology, with Australian consumers being the ultimate beneficiaries.

We have a "here and now" problem that, unlike other cable operators, SingTel Optus is exploiting the availability of regulated access to disinvest in its network – a network that it deployed specifically to service the same customers that it now elects to service through regulated access to Telstra's network. SingTel Optus could hardly invest less if the exemption were granted than it invests now with regulated access. As the leading US economist, Jeff Eisenach says:

> *"Having built its network before ULLS existed, it now finds that it has over-invested: it constructed a network capable of economically serving far more premises than is optimal given the ULLS-enabled cherry picking strategy now available to it. As a result, it is slowly un-investing in its network and focusing its efforts on "rebalancing" in order to maximize profits under the new strategy.*[106]

In its final decision on the HFC exemption, the ACCC dismisses the benefits of end to end facilities-based competition [despite a decade or more of positive statements to the contrary], considering that they are not necessarily greater than those of partial facilities-based competition based on ULLS. The ACCC is alone in this view. It is widely accepted amongst economists and regulators around the world that inter-platform competition delivers greater consumer benefits than intra-platform competition – more product innovation exploiting the different technical capabilities of the different platforms, more price competition because the

[106] Dr Jeffrey Eisenach, *Expert Report: Evidence Relating to the ACCC's Draft Decision Denying Telstra's Exemption Application for the Optus HFC Footprint*, 13 October 2008 p 16.

costs differ, stronger competitors because they have more autonomy and independence from each other. And once they have invested in their networks, facilities-based competitors will compete fiercely for the marginal customer because their costs are more fixed, and less variable.

Indeed, until Telstra's HFC exemption application, the ACCC itself has long chanted this mantra over the last decade or more. Clearly there are deep flaws in the current access regime and the discretion available to the regulator in how that regime is regulated for this dysfunctional environment to have been allowed to develop and persist.

A very similar story can be told in the Australian Capital Territory where the imposition of below cost access to the Telstra network appears to have contributed significantly to the decision by TransAct to stop the rollout of its cable network in preference to using regulated access of the Telstra network.

The telecommunications regulatory regime disincents investment because the ACCC has exercised its broad discretions under Part XIC – in both deciding to regulate and then determining the terms of supply of regulated services – in a way that gives asymmetrical weight to promoting the short-term entry of competitors at the cost of investment incentives which would have greater long-term benefits for consumers.

This is particularly problematic in light of the many uncertainties around investment in next generation networks. Telstra has been required to provide access below cost, and competitors face incentives to refrain from building or using their own infrastructure (SingTel Optus' use of regulated access within its HFC network is unique amongst cable operators globally). This policy has also led, as Professor George Yarrow predicts, to the situation where no one – Telstra or its competitors – is prepared to invest in next generation infrastructure given the risk of the ACCC taking a similar asymmetrical approach to new infrastructure.[107]

D.7 Support for Telstra's views

Global Access Partners (GAP) Regulating in Technology Rich Environments Task Force 2008, for which Telstra was a contributor, issued a paper at GAP's 2008 Congress on Regulatory Affairs, highlighting these very flaws in Part XIC and the stifling effect of the regulatory uncertainty thereby created on incentives to invest in next generation broadband infrastructure[108] (the GAP Paper).

The Paper contends:

- *"It is widely accepted that the current telecommunications third party access regime has failed to deliver. That regime has resulted in competition largely based on the resale of Telstra's network and services, rather than the development of new networks and services, and hence has become ever more dependent on*

[107] Prof G. Yarrow and Dr C. Decker, *Reflections on policy issues raised by next generation access networks in communications*, p.23 at http://www.dbcde.gov.au/communications_for_business/funding_programs__and__support/request_for_submissions_on_regulatory_issues/submissions/George_Yarrow_and_Christoper_Decker.pdf

[108] GAP Regulating in technology rich environments taskforce, *Regulating in technology rich environments – Directions for reform of Part XIC of the Trade Practices Act*, at: http://www.globalaccesspartners.org/Regulating%20in%20Technology%20Rich%20Environments%20Task%20Force%20Report%20FINAL%20for%20publication.pdf

perpetuating access regulation rather than producing sustainable commercial outcomes. At the same time, potential investors – including Telstra and its competitors – have effectively refused to devote capital to any significant upgrading of the existing network for so long as the current regime remains in place. As a result, the transition to a National Broadband Network (NBN) – or more generally to genuine high speed broadband – has been delayed while the existing fixed network is showing ever-increasing signs of age and is not capable of meeting the needs of Australia's economy and society."[109]

- *"Part XIC vests excessive discretion in the regulator in terms of what is regulated and how it is regulated. It does not accord with the principles of regulatory best practice."*[110]
- *"The Part XIC Undertakings regime has failed in its objective of providing industry certainty. The lack of clear principles puts the onus all on the submitter of the undertaking. The lack of any merits review of arbitrations provides an incentive to reject Undertakings."*[111]

For ease of reference, Telstra has appended the GAP Paper to this submission as Attachment 1.

The GAP Congress recommendations included:

> *Telecommunications regulation requires radical reform to encourage the major investment necessary to modernise Australia's inadequate broadband provision*.[112]

[109] GAP paper, page 4
[110] GAP paper, page 1
[111] GAP paper, page 2
[112] See the report of the Congress at http://www.globalaccesspartners.org/eventreg.htm#online

E. REFORMING TELECOMMUNICATIONS ACCESS REGULATION

Telstra offers two sets of recommended reforms to Part XIC of the TPA. The first are a set of readily implementable minimum required reforms to address the most grievous issues identified in this submission, in an effort to address the problems which are increasing the regulatory burden upon access providers in this industry, and thereby constraining urgently required investment in high-speed broadband infrastructure. The second is a set of principles that Telstra believes should underpin wholesale reform of Part XIC to align it with best practice access regulation.

E.1 Minimum required reforms

The urgent recommendations set out below are *additional* to those recommended in section C.

R6. A mandatory pricing principle be implemented under Part XIC requiring that regulated access prices should be set on the basis that only users of the access service must pay for the costs incurred in providing the service.

R7. Part XIC of the TPA should be reformed to ensure the same evidentiary hurdle is applied to ACCC decisions to declare services is applied to ACCC/ACT decisions to grant exemptions, as well as the same hurdle to accept or reject undertakings and to set prices. It should also be made explicit that proper regard should be had to the "forward looking" incentives to invest, in the decisions both to regulate and deregulate, and in setting access prices, with an explicit bias toward promoting platform-based competition.

R8. Provision for amendment of Part XIC undertakings should be made, similar to the process for digital radio multiplexer access under the Radiocommunications Act.

R9. The special access undertaking and anticipatory exemption provisions of Part XIC should be reformed to ensure they are capable of providing regulatory certainty as originally intended.

R10. The ACCC's discretion to arbitrate access disputes under Part XIC should be amended to preclude arbitration where there is in force a contract between the parties on the issue claimed to be in dispute.

E.2 Comprehensive review to align access regulation is required

Section 44AA of the TPA sets out the objectives of Part IIIA:

> *The objects of this Part are to:*
> > *(a)promote the economically efficient operation of, use of and investment in the infrastructure by which services are provided, thereby promoting effective competition in upstream and downstream markets; and*
> > *(b) provide a framework and guiding principles to encourage a consistent approach to access regulation in each industry.*

Thus the objectives of promoting efficient investment and consistency of regulation are at the forefront of every Australian access regime except that for telecommunications. In contrast the most burdensome and confronting problems with the telecommunications access regime are the absence of consistency and the adverse consequences of the regulatory uncertainty thereby created for efficient investment.

Part XIC requires comprehensive reform to align it with recent developments in access regulation which, with the notable exception of telecommunications, has seen significant reform since Part XIC was last reviewed in 2001.

The overarching principle for a new telecommunications access regime should be achieving consistency, where practical, with recently reformed and revised, access regimes, specifically Part IIIA and the national electricity and gas access regimes.

This "consistency principle" should drive an alignment of the new telecommunications access regime and the best-practice features of the access regimes in other industries. Those regimes will have their own challenges as the need for new investment in transport, port and renewable energy infrastructure manifests.

Given the level of competition now experienced within telecommunications, and the commonality of issues across other infrastructure-based industries, in particular the need for further investment, there is no basis for treating it so uniquely and failing to account for pro-investment reform in other industries.

R11. Part XIC should be completely reformed. A set of principles for reform, based on the consistency principle, are set out in Attachment 2.

F. PREVENTING COST RECOVERY DETERS AND DISTORTS INVESTMENT

F.1 USO standard telephone services

Under the *Telecommunications (Consumer Protection and Services Standards) Act* 1999, Telstra is the sole Universal Service Provider (USP) for Australia. This means that Telstra is required to make a standard telephone service reasonably accessible to all Australians on an equitable basis, wherever they reside or carry on business. Telstra supports the policy intent, but says the funding arrangements are inadequate and in urgent need of reform.

Current USO arrangements are a legacy of a scheme established at a time when Telstra was a monopoly provider and fully Government owned. Despite the growth in competition since deregulation, the old USO arrangements prevail. It has now become an outdated, inefficient system, which lacks competitive neutrality, is burdensome on Telstra and its shareholders, and does not afford customers choice in high cost areas. The crux of the problem is that the USO scheme is grossly under-funded, non-transparent, relies on a flawed funding model and uses an outdated definition of a USO Standard Telephone Service (STS). These issues can be summarised as follows:

- **Underfunding of the USO:** The level of the subsidy has been artificially determined by previous Ministers at a level that bears no resemblance to the actual costs of delivering the standard telephone services and USO payphone services, and has spiralled downwards in line with a flawed annual trend adjustment. There is also significant uncertainty around future USO funding. Historically the subsidy amount has been determined by the Minister for a three year period, aimed at providing certainty for industry. However, the subsidy for 2008/09 is the most recent subsidy determined (2007/08 amount rolled over for a further year), and no decision for future years has been made. A significant adverse consequence of this is that it deters investment in high costs areas of Australia, both by Telstra as the Universal Service Provider (USP), and also by other providers, since such investments are likely to be commercially unsustainable.

- **Non-transparent subsidy:** Current USO arrangements are not based on actual costs – the subsidy does not reflect any sound analysis of the number, identity, and location of USO customers, nor the technologies used to service them. In effect this approach guarantees embedded regulatory error, which is perpetuated by the trend adjustment to the subsidy on an annual basis.

- **Inequitable funding of the USO:** As the USO subsidy is significantly less than the actual cost of delivering USO services, there is a significant and growing gap between the industry fund established to cover the cost of the USO and the actual cost, which Telstra bears as USP. This means Telstra and its shareholders bear a disproportionate share of the USO cost. This equates to a significant and unsustainable loss of competitive neutrality.

A long-term solution is imperative, in the face of the major issues outlined above. Such a solution needs to be based on a robust knowledge of the number of USO customers, the actual costs for providing USO services to the highest cost customers, and the existing and likely future technology solutions/replacements over the longer term, to ensure the most efficient solutions are costed.

In line with the Government's competition policy, the long-term solution should also involve the introduction of contestability wherever possible. In those areas in which contestability can exist, consumers in high cost areas will benefit from competition, including greater consumer choice, better service quality, lower prices and greater incentives for investment in telecommunications infrastructure enjoyed by their counterparts in other areas of Australia. Various models of contestability could be considered, ranging from a consumer voucher system to reverse auctions or hybrids of both these designs. Where contestability can be introduced there would be scope to wind back regulation in these areas.

An integral element of developing a suitable long term solution is to change the current funding arrangements. Quite apart from the key current problem of Telstra bearing a disproportionate share of the USO cost, an industry model is, in any case, an inefficient funding method. Under this scheme, telecommunication customers pay for the Government's social policy objectives. Since the benefits of telecommunications services flow throughout the entire country, consumers should not be the only contributors to the cost. Rather, society at large should pay through their tax payments to the Government. In this way the Government directly funds its own social policy objective. A further benefit of broadening the tax base is that by spreading the burden more broadly, there is a reduced deadweight loss of taxation.

F.2 USO payphones

The USO obligation extends to ensuring that payphones are reasonably accessible to all people in Australia on an equitable basis, wherever they reside or carry on business. In fulfilment of this obligation, Telstra owns and operates USO payphones nationwide. Under the funding arrangements for Telstra as the USO provider, the amount of funding allocated to payphones nationally is $13.8 million. In 2008, Telstra calculated that its annual loss for these payphones was approximately $39 million. This means that, as in USO STS provision, Telstra also wears a disproportionate share of the cost of delivering USO payphones. As a result there is little incentive to invest in this business. Other pertinent issues include the loss of competitive neutrality and loss of consumer choice.

A long term solution to this inefficient and unsustainable situation is required. It could be developed and implemented independently of the rest of the USO scheme. Any solution developed should also take into account recommendations made in the report of the Regional Telecommunications Independent Review Committee (RTIRC). This Review recommended consideration of a payphone subsidy program which allows all payphone providers to bid for funding on an open and transparent basis, and a stronger role to be played by groups such as local councils with regard to the location and removal of payphones in their area.

Solutions could include a reverse auction tender process for payphones, with the successful operating and maintaining the payphones, consulting with local governments on the location and numbers of payphones in their area, and advising Government on introducing new payphone technologies (such as multimedia kiosks), costs and migration. This solution has the advantages of giving the Government direct control of the numbers of payphones, their location (in conjunction with local government consultation) and their functionality. It would also overcome the intractable issue of funding Telstra's USO commitment to payphones.

G. PART XIB OF THE TPA – DUPLICATIVE & UNNECESSARY

As the Taskforce recognised, regulation should only be invoked where its benefits clearly outweigh its costs[113]. Much of the telecommunications regulation invoked or retained throughout the last decade has not been subject to a rigorous cost-benefit analysis. This is reflected in the plethora of regulation that is redundant, duplicative, inefficient or simply unnecessary.

In this Section G, Telstra submits that as Part XIB of the Act is duplicative, redundant and increases regulatory risk, it should be repealed. If, however, the Commission is not minded to recommend the repeal of Part XIB, then at the very least, it should be reformed to improve is efficacy and reduce the extent to which it creates uncertainty.

In this Section:

- Part 1 provides a brief overview of Part XIB and its history.
- Part 2 reviews the experience to date with Part XIB and explains why the anti-competitive conduct provisions are duplicative and unnecessary.
- Part 3 examines the costs imposed by Part XIB.
- Part 4 argues that the retention of Part XIB cannot be justified given the well established nature of competition in Australia's telecommunications market.
- Finally, Part 5 outlines how Part XIB could be amended to overcome its most burdensome shortfalls.

1. Part XIB: an overview

Part XIB of the TPA establishes a telecommunications specific anti-competitive conduct regime which augments Part IV of the TPA. Part XIB prohibits a carrier or carriage service provider with a substantial degree of market power from engaging in conduct that:

- has the effect or likely effect of substantially lessening competition; or
- contravenes specified sections of Part IV of the Act.

Both Part XIB and Part IV prescribe general rules of conduct which are enforceable by the courts. There are however a number of important differences between Part XIB and s46 of the Act:

- Part XIB applies only to telecommunications markets while Part IV applies to all markets;
- Part XIB makes use of an *effect or likely effect* test, whereas s46 uses a *purpose* test;
- Part XIB, but not Part IV, allows the ACCC to issue competition notices to firms it alleges are engaged in anti-competitive conduct, with a Part B competition notice having the effect of reversing the onus of proof in relevant proceedings, with the threshold to issue being merely 'a reason to believe'; and
- The pecuniary penalty in Part XIB ($10 million plus $3 million per day that the contravention continues for the first 21 days, then $1 million per day thereafter) is potentially much greater than in Part IV ($10 million).

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[113] The Taskforce endorsed six principles of good regulation of which one was: Only the option that generates the greatest net benefit for the community, taking into account all the impacts, should be adopted.

Part XIB has operated since 1 July 1997. In introducing Part XIB, the Government envisaged that it would be transitional in nature. The intention was that, once competition was established in telecommunications markets, the industry would be governed by the same regulations as apply to other industries:

> *It is intended that competition rules for telecommunications will eventually be aligned, to the fullest extent practicable, with general trade practice law. Part XIB will apply for the period from 1 July 1997 until some future review determines that competition is sufficiently established that the Part or some provisions of the Part are no longer needed.*[114]

In its 2001 review of telecommunications competition regulation the Productivity Commission concluded as follows in relation to Part XIB:

> *In comparison to Part IV, Part XIB has the advantages of being speedier … it should better detect and deter anti-competitive conduct. Part XIB has the potential negative effect of encouraging regulatory error and overreach and deterring acceptable pro-competitive conduct – but on the limited public information available, this had not been a problem to date. However, Part XIB lacks procedural fairness and transparency and has been used in some cases where other mechanisms, such as access regulation, could have been more appropriate.*
>
> *On balance, the Commission supports retention of Part XIB pending the development of more sustainable competition in telecommunications. This support is conditional on the introduction of an appeal mechanism intended to enhance procedural fairness.*
>
> *As Part XIB should only be a transitional measure, it should be further reviewed in three to five years.*[115]

The recommendation of the Productivity Commission to retain Part XIB was acted upon but no appeal mechanism was implemented and Part XIB has not been reviewed since.

It is also worth noting that in addition to Part XIB, there are numerous other regulatory instruments which provide the ACCC with powers to investigate and take action against alleged anti-competitive conduct by Telstra or another market participant. Table 2 summarises the alternative avenues open to the ACCC – both under the TPA and other regulation – in relation to the most likely instances of anti-competitive conduct to which Part XIB would be applied: alleged anti-competitive vertical price squeeze, discrimination against wholesale customers and a refusal to supply certain wholesale services.

[114] Explanatory Memorandum, Trade Practices Amendment (Telecommunications) Bill 1996, p. 7
[115] Productivity Commission, *Telecommunications Competition Regulation Inquiry Report*, 20 September 2001, page 151

Table 2

Potential breaches:	Price squeeze	Discrimination	Refusal to supply
Part XIB	Competition notice, penalties, damages; record-keeping & reporting; s.155	Competition notice, penalties, damages, record-keeping and reporting; s.155	Competition notice, penalties, damages; s.155
Section 46	Injunction, penalties, damages; s.155	Injunction, penalties, damages; s.155	Injunction, penalties, damages; s.155
Part XIC	Price regulation of declared services	Standard access obligations for declared services	Standard access obligations for declared services
Operational separation	Reporting margins	Reporting equivalence of non-price terms	
Accounting separation	Reporting margins	Reporting equivalence of non-price terms	

It is clear from Table 2 that Part XIB is entirely duplicative of other regulatory powers and provisions.

2. Experience under Part XIB

Since the introduction of Part XIB the ACCC has conducted a number of investigations, of which five resulted in the ACCC issuing competition notices — all against Telstra[116]. All of those investigations where competition notices were issued could have been dealt with effectively and quickly under Part IV of the TPA, or alternatively could have been the subject of a declaration inquiry under Part XIC of the TPA (although in Telstra's submission, as none were bottleneck services, they should not have been declared) – see Table 3.

[116] Despite this, at no time has Telstra been found by a court to have breached the competition rule nor has it conceded to breaching the Act. In fact, in the most recent matter, the Wholesale Line Rental (WLR) matter, a court formed the view that the ACCC was not entitled to issue the Competition Notice and ordered that it be set aside and quashed.

Table 3

Matter	Duration	Nature of alleged anti-competitive conduct	Alternatives open to the ACCC under the TPA
Internet peering arrangements	Jul 97 — Jun 98	Alleged breach of the competition rule by charging its Internet access provider (IAPs) competitors for certain services while at the same time not paying for similar services received from IAPs	• S46 — allege anti-competitive purpose by refusing to peer • s45 — allege Telstra's existing agreements with IAPs had an effect of lessening competition • Part XIC — consider declaring an Internet interconnection service if it is a bottleneck
Commercial Churn	Aug 97 — Feb 00	The ACCC alleged that various terms and conditions under which Telstra offered to churn a customer's services or account from Telstra to a service provider which was reselling Telstra's telephony services, were a use of Telstra's market power and had the effect or likely effect of substantially lessening competition. The ACCC was particularly concerned with the prices charged by Telstra, notwithstanding that Telstra had set its prices conservatively at levels which were below its actual costs of providing the service.	Part XIC – consider declaring the churn service if it is a bottleneck
Layer 3 ADSL/ Flexstream	Sept 01 — May 02	The notice alleged that: • the pricing of Telstra's Flexstream product (wholesale ADSL) was too high; • that Telstra refused to supply a layer 2 wholesale ADSL service; and • taken together Telstra conduct had and has the effect, or likely effect, of substantially lessening competition.	• S46 — allege that Telstra had engaged in price squeeze and a refusal to supply for the purpose of lessening competition • Part XIC — consider declaring a wholesale Layer 2 ADSL service if it is a bottleneck
ADSL pricing	Feb 04 – March 05	ACCC was concerned that Telstra's retail price reductions were not matched by a similar reduction in its wholesale price for similar services. It alleged that Telstra was engaging in a price squeeze which was likely to substantially hinder the ability of Telstra's wholesale customers to compete at the retail level	• S46 — allege that Telstra had engaged in an anti-competitive price squeeze for the purpose of lessening competition • Part XIC — consider declaring the wholesale ADSL service if it is a bottleneck
Basic access pricing	Nov 05 – Feb 07	The Competition Notice alleged that Telstra's wholesale price for it Home Access service had an anti-competitive effect in the broader retail market for bundled services.	• Before revoking the competition notice the ACCC declared Wholesale Line Rental under Part XIC of the TPA, even though it is not a bottleneck service • The Commission could have also chosen to allege a anticompetitive price squeeze and to pursue this matter under s46 of the Act

In addition to again highlighting the duplicative nature of Part XIB, the cases detailed in Table 3 also show the lack of speed involved in the regime. For example, resolution of both the Commercial Churn and the ADSL broadband matters took 18 months and 13 months respectively. Hence, it is questionable whether a Part XIB action would produce a more timely resolution of alleged anti-competitive conduct relative to a Part IV action.

3 Part XIB imposes cost and creates regulatory uncertainty

Part XIB has been used as a costless complaint mechanism for Telstra's competitors, which has resulted in the imposition of direct costs on both the ACCC and Telstra for no discernible benefit. See Example 17.

Example 17 – Wholesale basic access competition notice 2006

Having engaged with the ACCC since September 2005, Telstra initiated the following price changes on the 1 December 2005:

- a $5.00 increase (to $31.95 incl. GST) in the monthly price for HomeLine Part ; and
- an increase in the wholesale price for Home Access from $24.50 to $27.60 (ex-GST).

These price increases were in response to the unprofitable nature of these standalone offerings, falling PSTN call volumes and impending retail price cap changes.

The ACCC approved the price increase for Telstra's retail HomeLine Part offering on 24 October 2005. Then on 30 November 2005 (one day before the proposed price change was to take effect) the ACCC sought an undertaking from Telstra not to implement the proposed wholesale price change. This last minute action from the ACCC caught Telstra by surprise given that:

- the ACCC had not raised any issues previously, nor had it sought further information from Telstra;
- with the exception of Optus, many Telstra Wholesale customers had accepted the price increase and were not opposed to it.

The ACCC subsequently issued a Consultation Notice on 22 December 2005, alleging anti-competitive effect in the retail fixed voice (bundle) market. While Telstra attempted, on several occasions, to engage with the ACCC regarding its concerns it was unsuccessful. Telstra did however lodge a submission with the ACCC in response to the Consultation Notice.

Despite almost no meaningful consultation by the ACCC, a Competition Notice was issued on the 12 April 2006. The Competition Notice alleged anticompetitive effect not only for elements of a bundle but also on the Low Spend Customer segment. Importantly, the conduct referred to in the Competition Notice was different to that referred to in the Consultation Notice.

Six days later (of which four were the Easter holiday) on 18 April 2006 Optus commenced proceedings against Telstra in the Federal Court claiming breaches of both Section 46 and Part XIB, the latter based on and consistent with the Competition Notice.

Inconsistent with Optus' legal claims of anti-competitive effect Optus raised its retail line rental prices in February 2006 by $2 per month and again in February 2007 by between $5 and $7 per month.

In August 2006 the ACCC declared wholesale line rental and later issued indicative prices that were, on average, equal to Telstra's WLR and LCS Home Access prices. The ACCC subsequently revoked the competition notice declaring that the matter had been resolved under Part XIC of the Act. Optus, however, continued with its proceedings until April 2007 when the Federal Court found in Telstra's favour that the ACCC had not afforded Telstra natural justice or procedural fairness. The Court ruled that the Competition Notice should be set aside and quashed.

Despite Telstra's success in arguing it was not afforded natural justice or procedural fairness, it was clearly no winner. Since first engaging with the ACCC in September 2005, defending the ACCC's allegation of anti-competitive conduct consumed considerable resources over a protracted period of time. Moreover, Telstra's decision not to change its market conduct exposed it to significant financial penalties.

There were no doubt significant costs for the ACCC as well. These, however, could have been avoided if the ACCC had chosen to effectively consult with Telstra and perhaps consult with industry more widely, relying less on what appeared to be an unsustainable complaint of a single complainant.

Furthermore, the use of Part XIB as a substitute for Part XIC (as the above Table 3 indicates has occurred) undermines regulatory certainty. To the extent that Part XIB enables the ACCC to force certain services to be provided, or services to be provided on certain terms, it functions as a de facto access regime. If the ACCC can characterise conduct as having an anti-competitive effect – as it did with the terms of supply of Internet access and commercial churn and the characteristics of the wholesale ADSL service – it can effectively regulate the terms of wholesale access without having to clear the hurdles to declaration of the service. In this way it can also target its attention at a particular provider, rather than all providers of the relevant service.

As argued above, Part XIC requires urgent reform to reduce the uncertainty arising from the ACCC's broad discretion to regulate access. Part XIB must be reformed at least to the extent that it gives rise to the same uncertainty.

4 No basis for the retention of Part XIB

Telstra submits that competition in all of Australia's telecommunications markets is sufficiently established as to provide no justification for the retention of Part XIB. In fact, evidence sourced from the industry's regulators (the Australian Communications and Media Authority (ACMA) and the ACCC) and cited in Section C.1 clearly demonstrates that Australian consumers face real choice of telecommunications providers offering a range of services utilising various technologies and access infrastructure.

Moreover, relative to other industries Australia's telecommunications industry is highly competitive. For example, relative to the petroleum and domestic aviation industries Australia's telecommunications industry is characterised by more market participants, lower levels of industry concentration[117] and lower barriers to entry. Despite this healthy level of competition, neither the domestic aviation nor the petroleum industry is subject to industry specific market conduct regulation additional to those that exist in Part IV of the TPA.

[117] Together Australia's top four petroleum refiners account for 98% of total production, while Qantas (including Jetstar) and Virgin Blue account for almost 100% of Australia's domestic aviation industry.

Telstra submits that competition in telecommunications is sufficiently established as to provide no justification for the retention of Part XIB. Hence, consistent with the original intent of the 1997 Telecommunications reforms and the Commission's own 2001 review the competition rules for telecommunications should now be aligned, to the fullest extent practicable, with general trade practice law.

5 Addressing the procedural problems with Part XIB

If the Commission is not sufficiently persuaded to repeal Part XIB on the grounds that competition in the telecommunication industry is well established, and that Part XIB is duplicative and unnecessary, the Commission should at the very least recommend amending Part XIB so as to improve its efficacy and reduce the uncertainty which it creates for market participants.

In particular, Telstra submits that reform is needed

- to ensure the ACCC advises a party to which it proposes to issue a competition notice of the substance of the allegations against it, the reasons for those allegations, and what the party can do to address those allegations and thereby avoid a breach of the competition rule, before it is empowered to issue a competition notice; and
- to ensure competition notices are enforced within a reasonable period or else fall away – a 'use it or lose it' requirement to hasten a court decision where needed.

These reforms would be beneficial:

- For entities regulated by Part XIB, because the Part XIB process will be improved and they will have greater clarity of the allegations against them, and where those allegations are without substance, they will not be subject to protracted contingent liability under a competition notice. The consultation notice mechanism is not merely a "letter before action" as has been claimed by the ACCC, but is designed to require the ACCC properly to consult and inform the carrier of its views with the primary object of avoiding the need for a competition notice in the first place;
- For competition which is protected by Part XIB, because regulated entities will be provided with the information necessary to be able to respond quickly to address breaches, and if they do not, alleged breaches will be required to be dealt with by a court, at the instigation of the ACCC.

Additionally, Telstra recommends that if the Commission does not recommend the repeal of Part XIB, it should recommend a legislative requirement for further review of Part XIB after three years, with a rebuttable presumption that it be repealed unless there is a demonstrable net benefit.

H RETAIL PRICE CONTROLS – REDUNDANT

The Telstra Price Control Determination No 1 of 2005, ('the price controls') is regulation designed to address a problem that no longer exists.

The current Determination is the latest iteration of regulation that commenced in 1989, prior to the introduction of competition, at a time when Telstra's predecessors (Telecom Australia and OTC) were statutory monopolies.

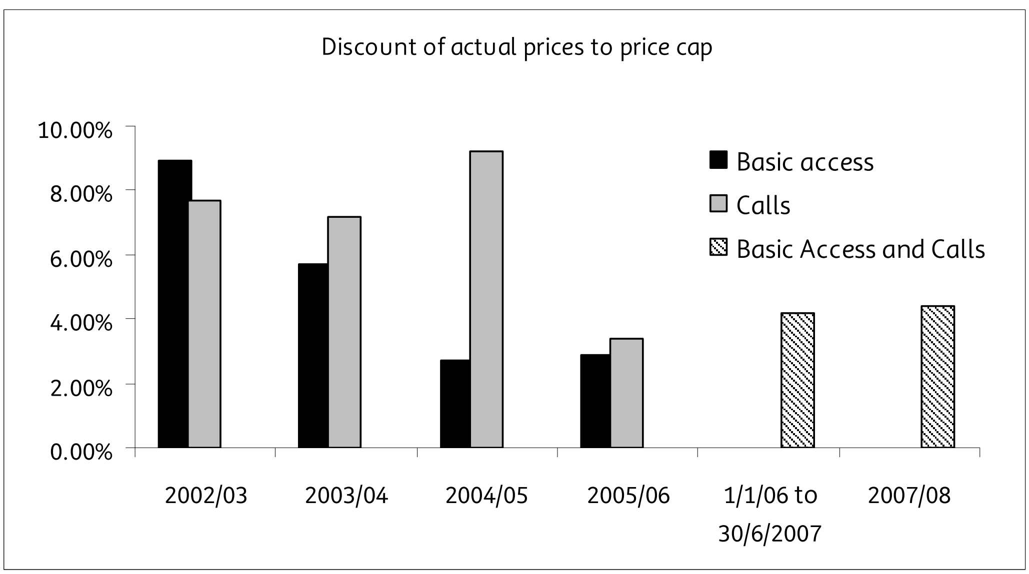
The primary goal of the price controls is to simulate the effect of a competitive market on Telstra's fixed voice retail prices. Such regulation is no longer needed in an environment where consumers have a multiplicity of alternative and substitutable communications options available to them.

The Australian telecommunication market has:

- 372 fixed voice providers;
- experienced falling prices for voice services for the last three years;
- mobile phone penetration - a substitutable product to fixed services - at 100% with four competing network operators and numerous resellers; and
- growth in the take up of VOIP services, Engin reporting an increase of active subs of 8.6% from 12 months ago and MyNet Phone an increase of over 71%.

The forces of competition and the emergence of new technologies are a competitive constraint on Telstra's retail prices. Evidence of these competitive pressures on Telstra's retail prices can be illustrated in Figure 5 which sets out the relativities of Telstra's prices to the price cap since 2002[118].

Figure 5



[118] The current Determination came into effect from 1 January 2006. It has a combined price cap for line rental and local calls whereas the previous Determination provided separate caps.

These results show that Telstra's prices are consistently below the regulated price cap. For example, for the latest price cap period, Telstra could have charged 4.4% more for those services and still have stayed within the confines of the price controls. It did not do so because it was constrained by competition.

Moreover, the price controls are redundant as there is an open access regime which allows Telstra's competitors to replicate Telstra's fixed service offering. All of the services subject to the price controls are regulated at the wholesale level of the market. Telstra's competitors are able to buy these services at regulated prices effectively set by the ACCC. Thus, if Telstra were to attempt to charge retail prices above the competitive market level, then a carriage service provider could buy the input products from Telstra Wholesale at the ACCC regulated price and on-sell to consumers, ensuring that prices returned to a competitive level. Furthermore, Telstra is currently required to sell unbundled local loops to competitors. This means competitors are able to supply their own telephony products in competition with Telstra, including through the combination of Naked DSL and VoIP.

The continued existence of the price controls with no signal from the Government for their removal stands in stark contrast with the rest of the world where retail telecommunications price controls are being completely removed (i.e. the UK, France and the Netherlands), and also domestically where recommendations have been made to remove price controls in the Victorian and South Australian energy markets[119]. Competition in telecommunications is far more intense than in retail electricity markets in which it is essentially limited to resale.

The growing irrelevance of the current price controls has been recognised by the Commission itself which, in its recent Review of Australia's Consumer Policy Framework states:

> "*…the Commission is proposing that all retail price regulation applying to telecommunications products and services and to contestable energy services should be removed. In those markets, competition among suppliers will best serve to keep prices in check.* [120]"
>
> "*Retail price regulations for telecommunications and energy services were introduced as a transitional measure following the deregulation of service provision, subject to review and removal once full contestability had been established. Yet though some of these markets are now very competitive, many of these interim price regulations remain in place*[121].
>
> *Hence, once utility markets are fully contestable, as the telecommunications market evidently already is – retail price regulation should be abolished.*"[122]

This redundant regulation impacts Telstra in the following ways:

- It disrupts Telstra's business planning – revenues and CPI must be constantly monitored, forecasts must be made years into the future to 'guess' the impact any new product will have on price control compliance.

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[119] Australian Energy Market Commission (AEMC) has recommended the removal of price controls from the Victorian and South Australia electricity markets. The AEMC analysis used a set of clear criteria to determine the effectiveness of competition within the Victorian energy market. AEMC Review of the Effectiveness of Competition in the Electricity and Gas Retail Markets in Victoria, First Final Report, 19 December 2007.

[120] Productivity Commission Inquiry Report, Volume 1 - Summary, No.45, 30 April 2008, Page 31.

[121] Productivity Commission Inquiry Report, Volume 2 – Chapters and Appendixes, No.45, 30 April 2008, Page 113.

[122] Ibid, page 115.

This impacts on Telstra's competitiveness as it cannot respond to competition quickly and flexibly;

- It delays consumer benefit from innovative pricing – for example, when Telstra introduced a new pricing construct, it first had to negotiate with the ACCC to establish how the price control methodology would treat the new construct;

- It dampens competition by providing competitors with certainty as to the range of pricing that Telstra will have in market over the longer term. Telstra cannot price too low lest it engages in a price squeeze under Part XIB of the TPA and cannot price too high due to the price controls. This creates forward looking predictability of Telstra's prices, courtesy of regulation; and

- It creates business uncertainty as the price controls can be changed by the Government at any time.

For these reasons, Telstra concurs with the Commission's recommendation that the retail price controls in telecommunications be repealed.

I INDUSTRY TAXES – FUNDING BASE TOO NARROW

ACMA is the third largest collector of Government taxes and levies and typically collects in excess of $250 million from telecommunication service providers annually[123]. There is considerable scope to gain economic and administrative efficiencies through placing less reliance on ACMA as a collector of telecommunication industry taxes and moving toward direct Government funding.

Key areas recommended for moving tax collection from ACMA, through a shift from industry funding to direct Government funding for provision of social policy objectives, include:

- **USO levy:** Under current arrangements ACMA collects carriers' shares of the USO levy and reimburses Telstra. This process generally takes at least six months after the financial year in which Telstra has provided the USO. Based on the earlier discussion, the industry funding model is flawed and Government should fund the USO directly through Consolidated Revenue, consistent with its own stated competitive neutrality policy. In addition, this would eliminate efficiency losses that are incurred in the current arrangements due to the administrative costs of determining each carrier's eligible revenue. Such costs are only likely to increase over time, with increasing numbers of telecommunications providers and a rapidly expanding number of revenue-generating services which contribute to the "eligible revenue" basis for the levy.

- **National Relay Service (NRS):** The NRS, including the Outreach program, costs approximately $15M to operate annually. Under current arrangements, the industry is required to fund the service, ACMA administers it and a third party provides it. As the chain of accountability is broken, the incentive for Government to ensure that the service is delivered cost effectively is removed. Similarly, carriers, as the taxpayers, have limited visibility of the performance of the program.

  If Government funded this service directly, not only would there be gains in administrative efficiency, but also improvements in operational efficiency, given the stronger link to the public service which should ensure public money is spent efficiently.

  As the NRS is provided as a means of fulfilling the Government's social policy objective, it should be funded directly by Government. This would improve efficiency through lower collection costs and spreading the tax burden from telecommunication users only to society as a whole. It would also have the advantage of facilitating improvements or expansions of the service to be made, as the Government desires.

- **Annual Carrier Licence Charge:** These charges, collected by ACMA, are levied on licensed carriers to recover the cost of regulating the telecommunications industry. As regulation is deemed by Government to be in the national interest, all Australians should pay for it, through tax revenue. Spreading the tax burden widely via direct Government funding would improve economic efficiency.

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[123] ACMA, *Australia's Future Taxation System Review,* (submission to the Government's Review of the tax system), November 2008 (p1)

J REDUNDANT LICENCE CONDITIONS – LOW HANGING FRUIT

The telecommunications sector faces a raft of duplicative regulatory and reporting burdens, the majority of which are borne by Telstra. Telstra faces regulations based on outdated and retired technologies and services. For example,

- There are at least eight conditions in Telstra's carrier licence that are completely redundant yet have not been removed.
- Telstra regularly produces reports that are never used or, to our knowledge, even considered by government or regulators.
- Telstra faces regulations that prevent the development and onset of new products and services that would enhance people's lives and, at the same time, significantly reduce industry costs.
- Telstra is burdened by regulations that serve no valid purpose, are not solving any known consumer problem or market failure and have often been put in place for purely political reasons.

This extensive regulation, red-tape and reporting only serves to stymie investment, discourage innovation and make this industry less efficient and competitive than it otherwise would be. That this regulation remains in place is symptomatic of the lack of focus on efficient regulation of the telecommunications industry.

Attachment 3 sets out recommendations for red tape reforms that could be immediately implemented. These are "low hanging fruit" that have either no or extremely marginal policy implications.

We have grouped together these proposed reforms as low hanging fruit because they all:

- do not require legislative change,
- can be acted upon at the Ministerial/Departmental level or by ACMA/ACCC; and
- are uncontroversial from a public policy perspective.

K REDUNDANT RED TAPE REPORTING

K.1 Accounting separation

Accounting separation is enshrined in the Non-Price Terms and Conditions Key Performance Indicator Record Keeping and Reporting Rules ("the Non-Price Rules") and the Imputation Testing Record Keeping and Reporting Rules ("the Imputation Test Rules"), made by the ACCC pursuant to s 151BU of the TPA as a result of a Ministerial direction.

For the reasons set out below the Non-Price and Imputation Testing Rules have become obsolete and, therefore, the associated reporting requirements are an unnecessary and burdensome obligation imposed on Telstra.

The Non-Price Rules

The Non-Price Rules have been superseded. They require Telstra to report on 11 non-price metrics, all of which are also reported under the Service Quality Strategy reporting requirements of Operational Separation. Indeed, the requirements of Operational Separation are more comprehensive than they are under Accounting Separation, as they include 12 additional metrics.

The Non-Price Rules are inferior to their Operational Separation successors. When the Service Quality Strategy was being developed prior to the introduction of Operational Separation, the opportunity was taken to refine the accuracy of some of the original 11 Accounting Separation metrics. The result is that the metrics reported under Operational Separation more accurately reflect Telstra's service quality regulatory obligations than do the Accounting Separation metrics.

The Non-Price Rules impose a high resource burden on Telstra. Telstra has spent $523,600 on the external audit of the Non-Price Accounting Separation metrics from the implementation of the Service Quality Strategy metrics in the December 2006 quarter, which are intended to replace the Non-Price Accounting Separation metrics, until the March 2008 quarter (6 quarters). Without change, these expenses will continue.

The ACCC and the Department have agreed to abolish the Non-Price Rules. In a draft explanatory statement, the Department of Broadband Communications and the Digital Economy ("the Department") stated:[124]

> *"The Australian Government considered that it would be appropriate to make changes to the accounting separation arrangements so as to remove or streamline those elements which have been effectively superseded by operational separation, or whose continued implementation would require a significant expenditure of resources by the ACCC and industry. It was considered that making these changes would represent a significant reduction in industry reporting requirements.*
>
> *The Amending Direction is intended to remove most of the reporting requirements. In particular, it will remove the requirements (on both the ACCC and Telstra) to report on non-price terms and conditions and on Telstra's current cost accounts. It will also remove the requirement on the ACCC to report on competition in the corporate segment of the industry.*

The Department also noted:

> *"DCITA has received advice on this matter from the ACCC. The ACCC supports the proposed changes to accounting separation.*

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[124] Explanatory Statement, Australian Competition and Consumer Commission (Accounting Separation—Telstra Corporation Limited) Direction (No. 1) 2003 (Amendment No. 1 of 2007), Consultation Draft.

The Imputation Testing Rules

The information produced under the Imputation Testing Rules is demonstrably inaccurate. For example:

- total costs are used in the calculation of imputation test margins, when the appropriate measure is avoidable cost;
- the test assumes that all bundled business customers will buy exactly one ADSL service and exactly four PSTN services, which is far too general and plainly wrong;
- the bundled ADSL and PSTN results are wrong as they double count CAN costs;
- connection costs and revenues are excluded from the Accounting Separation imputation test reports; and
- the Accounting Separation reports fail to consider the line-sharing service (LSS and Wholesale ADSL as a means for access seekers to supply ADSL to end users.

Telstra strongly recommends that the requirement to produce the Accounting Separation imputation test reports be repealed to prevent any bad decision making taking place on the basis of such error-ridden information.

The information produced under the Imputation Testing Rules is inferior to the information produced for the Pricing Equivalence Framework ("the PEF") of Operational Separation. The methodology underlying the PEF reports remedies all the issues highlighted above with respect to the Accounting Separation imputation test reports.

The Imputation Testing Rules impose a high resource burden on Telstra. Telstra spends $88,000 per annum on the external audit of the Accounting Separation Imputation Testing reports.

Good Regulatory Practice

Despite the Non-Price and Imputation Testing Rules being superseded and made redundant by Operational Separation, Telstra continues to incur a high cost in meeting the reporting requirements.

Consequently, Telstra has requested the ACCC notify Telstra that it is no longer required to keep records and report in accordance with the Non-Price and Imputation Testing Rules, as the ACCC is empowered to do.

The ACCC's response to Telstra's request was to defer any decision, pending completion of a Ministerial review that was commenced by the previous Government and has not been concluded.

K.2 Tariff-filing

When competition was first introduced into the Australian telecommunications market through the *Telecommunications Act 1991*, Telstra was subject to a prescriptive retail tariff filing regime. Telstra was required to notify its retail price changes to the then regulator, AUSTEL. When the current telecommunications regulatory regime came into being, this retail tariff filing was carried over into Part XIB of the TPA in the most peculiar fashion. Telstra is still required to notify the ACCC of price changes to "basic carriage services" as defined under the 1991

Act – which is no longer operative. Today's regulatory regime does not otherwise use or recognise the concept of "basic carriage services".

The filing of retail tariffs is completely redundant. In addition to retail tariffs, the ACCC receives the following information about Telstra's retail pricing:

- Annual price control compliance report;
- Accounting separation limb 2 quarterly reports;
- Operational separation pricing equivalence framework quarterly reports;
- The Regulatory Accounting Framework (RAF), which is updated twice annually; and
- The ACCC is empowered to request information, require Telstra to compile documents or reports, and require Telstra to retain records, including about Telstra's pricing, under the Operational Separation Plan[125], and also has extensive general information-gathering powers under section 155 of the TPA.

In light of this duplication, and the competitiveness of the retail market, there is no need to continue with Telstra-specific tariff filing regulation at the retail level, let alone regulation that had its genesis in regulating the newly-emerging duopoly in 1991 (more than two regimes ago). Requiring Telstra to inform the regulator every time it changes a retail price provides no regulatory safeguard, informs no regulatory function and is entirely redundant.

K.3 CSG reporting

The government introduced the Telecommunications (Customer Service Guarantee) Standard (the CSG) in 1998 with the policy objective of improving the performance of service providers in connecting fixed line phones, and repairing faults with those phones, for residential and small business customers.

At that time, the number of fixed line phones exceeded the number of mobile phones and there were about three million subscribers to the Internet – primarily dial-up users. CSG monitoring and reporting arrangements were primarily structured around Telstra's place in the industry as the primary provider of fixed line phones, which it supplied on both a retail basis and through its wholesale customers on a 'resale' basis.

Significant changes have occurred within the telecommunications industry during the past 10 years where a significant change in consumer preferences can be observed. These changes are clearly illustrated in the Telecommunications Today series of reports published by ACMA[126]:

- The number of mobile phones has increased from eight million in 2000 to 21.2 million in 2007 - an increase of 165 per cent, to almost double the number of fixed line phones.
- Conversely, the number of fixed line phones was 10.6 million in 2000 and increased slightly to 11.7 million in 2004, but has declined gradually since then to 10.9 million in 2007. Of this amount, 7.9 million were classified as CSG services. The other three million phones

[125] Operational Separation Plan, cl. 6.8, 6.9, 6.10 at http://telstrawholesale.com/dobusiness/customer-commitment/docs/op_sep_plan.pdf

[126] These statistics are from ACMA, Telecommunications Today Report 5: *Consumer Choice and preference in adopting services*, April 2008, pp.8, 10

were phones that were not CSG eligible services, for example, phones used by large businesses.

- Nearly 90 per cent of respondents to an ACMA commissioned survey had both a fixed line phone and mobile phone in their household, and 87 per cent used both services.
- Nearly a quarter of respondents with both a fixed line phone and a mobile phone would consider substituting their fixed line phone with another form of communication.

In addition to the increased importance of mobile phones within the community, the other factor now starting to have a significant impact on the market is the increase in the take up of voice over internet protocol (VoIP) services. Information included in an ACMA research report[127] confirmed there were 269 providers of VoIP services in September 2007, of which 161 targeted the residential market. The report also forecast that the number of VoIP subscribers was expected to increase from 1.4 million in June 2007 to 4.8 million in 2011.

It is clear the telecommunications market will continue to evolve. The current dependency of consumers on mobile phones will only become greater as more consumers switch to 3G mobile phones in order to access the Internet and use email while away from home. In addition, access to higher quality broadband speeds will entice many consumers to take up VoIP services.

Greater numbers of consumers can also be expected to 'bundle' their telecommunication services into the one package in order to obtain the best possible pricing arrangements. This may involve 'waiving' their rights to CSG entitlements.

The reliance on fixed line phones has therefore diminished significantly since the CSG was introduced over ten years ago, and this decline is expected to continue.

ACMA's current arrangements for monitoring industry compliance with the CSG, require the reporting of extensive data on both a quarterly and annual basis. This reporting is excessive in light of the greater substitution of other services for the fixed line phone. The current monitoring arrangements also have a number of other deficiencies.

a) ACMA collects far more data from industry than it reasonably requires to fulfil its legislative obligations. For example, Telstra provides 90 separate items of CSG performance data each quarter plus a total of 464 performance items on an annual basis. This provides ACMA with a capability to analyse Telstra's CSG performance at varying disaggregated levels. It is not clear to Telstra why ACMA would need to monitor a provider's performance other than at the aggregate level.

In the event it has concerns, ACMA may in turn seek an explanation from the provider or give consideration to further monitoring options, for example, analysing complaint data.

This is in the context of an extremely competitive telecommunications market in which consumers have a significant amount of choice of services and providers.

In the event customers are dissatisfied with the level of service delivered by their provider, they are free to choose services from another provider, or they can elect to acquire a different type of service altogether. It is highly inequitable to

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[127] ACMA, *The Australian VoIP Market*, 20 December 2007

require such disaggregated levels of reporting from one type of service provider, while others (such as those providing VoIP services) provide none.

b) ACMA publishes too much data in its quarterly and annual reports. In addition to the summaries of performance for each of the four carriers who supply data to ACMA, each quarterly report includes eight pages of data tables containing highly disaggregated levels of data. ACMA's annual report then effectively replicates the quarterly data by providing an annual overview of CSG performance inclusive of volume data. This information overload is of no meaningful benefit to the intended recipients. This is exacerbated by the fact that ACMA rarely includes commentary about the reported results, thus leaving it open to readers to draw their own conclusions.

c) ACMA's approach to the collection and publication of data is inconsistent and potentially misleading. This has adverse implications for consumers and for the service providers whose performance thereby is misrepresented.

Example 18 – Inconsistencies in ACMA performance data collection and publication

- The 'Performance Bulletins' section of ACMA's web site contains performance data dating back to the March quarter 2004. However, the site does not include any fault repair data for Primus. Primus has clearly received faults during the period in question, as evidenced by the data contained in ACMA's annual reports[128].
- A further example relates to the data provided by Optus for its connection performance, which is based only upon those telephone lines directly connected to its own network in the capital cities on the mainland. Conversely, its fault repair performance data includes both those services connected to its own network, as well as resale services. It is therefore unclear to a reader of the report whether Optus' fault repair performance for rural and remote areas is based upon resale activity only.
- New service connection and fault repair performance for each of the four carriers is published in the same table, in a form that does not take account of the many factors that influence the performance of an individual provider. These include whether the performance is based upon services supplied via the provider's own network and whether the provider offers services in all areas of Australia, either commercially or as a result of the USO.
- Whilst both in-place and new service connection performance are reported in the quarterly reports, only new service performance is reported in the annual report.

Recommended reform

ACMA's approach should aim to provide consumers with an appropriate level of information to assist them in making choices of service and service provider. ACMA should then only request and report data that is reasonably necessary to fulfil its regulatory functions.

Specifically, Telstra recommends three major changes:

[128] See ACMA Telecommunications Performance Report 2004-05 and ACMA Communications Report 2006-07

a) ACMA should cease to request data where industry has proven that appropriate procedures are in place to ensure a high level of regulatory compliance. Examples include:

- The performance of industry in connecting in place services, which in 2006-076 was 96 per cent or above for each of the four carriers who supply CSG data to ACMA.
- The data published by ACMA each quarter demonstrating the performance of individual providers in identifying CSG liabilities within 14 days and discharging those liabilities within 14 weeks for the past two years has shown that industry performance is of a consistently high standard.

This high level of performance clearly raises the question as to why ACMA continues to request such data.

b) ACMA should transition CSG monitoring and reporting arrangements from the current quarterly/annual basis to an annual basis only, as the latter provides a far more consistent indicator of industry performance. Quarterly reporting serves very little benefit as the primary conclusion to be drawn is that performance generally declines during the December and March quarters, due to the impact of extreme weather events.

c) In conjunction with a transition to annual reporting, ACMA should reduce the amount of data that it seeks from industry on an annual basis. Telstra considers there are six fundamental indicators that would provide ACMA with sufficient data upon which to effectively monitor the CSG performance of industry, including providers of both fixed line phones and VoIP services:

> *Percentage of new services connected within prescribed timeframes [Urban, Rural and Remote]*
>
> *Percentage of faults repaired within prescribed timeframes [Urban, Rural and Remote]*

d) ACMA should pursue its announced intention[129] *to implement regulatory symmetry as between VoIP and other fixed voice services.* The reduced CSG reporting framework proposed by Telstra should apply equally to all providers.

K.4 CSG extreme failure reporting

The issue of the value of CSG extreme failure reporting has been the subject of extensive correspondence between ACMA and Telstra since October 2007. Telstra has consistently maintained the position that these reports are of no regulatory value, for the following reasons:

1. Consistent performance

Telstra provided ACMA with a total of 15 CSG extreme failure reports for the period from 1 April 2003 to 31 December 2006 - the June 2003 to December 2006 quarters inclusive.

Throughout this reporting period of just under four years, Telstra’s performance in connecting and restoring CSG services - when measured against the CSG extreme failure thresholds - had been of both a consistent and high standard. For this period:

[129] ACMA Media Release 38/2008, 16 April 2008

- 99.8% of CSG services were connected within the prescribed CSG extreme failure threshold, i.e. CSG timeframe plus five working days. Or to put it another way, from a total of 5,999,609 CSG connection orders, only 11,785 orders (0.2%) were connected outside this threshold - an average of 786 orders per quarter. Of these 11,785 orders, 8,011 or 68% were connected between six and 10 working days outside of the CSG timeframe.
- 99.4% of CSG faults were restored within the prescribed CSG extreme failure threshold, i.e. CSG timeframe plus five working days. Or to put it another way, from a total of 3,015,964 CSG restoration orders, only 17,054 orders (0.6%) were restored outside this threshold - an average of 1,137 orders per quarter. Of these 17,054 orders, 10,374 or 61% were restored between six and 10 working days outside of the CSG timeframe.

2. Regulatory Data does not reflect factors relevant to actual customer service delivery experience.

Extreme failure performance data does not necessarily take account of any extenuating circumstances that may apply in delivering service to customers, including the following:

- Free call diversions to a number of the customer's own choice, which are offered and supplied to customers at the time of reporting a fault;
- Interim services provided by Telstra field staff on an ad-hoc basis, for example, a mobile service that is provided to a customer until the technician is able to return with the necessary replacement parts to complete restoration of the fault;
- Instances of where a customer has assigned a lower priority to a CSG order, for example, where a customer advises there is no urgency to complete a complex restoration, due to the existence of other working services at the premises;
- Customer caused delays, for example, where there is a delay in obtaining access to a customer's premises;
- Delays caused by the requirement to issue land access notices where access to private property is required; and
- Situations where the time to connect or restore a service has been impacted by circumstances beyond Telstra's control but an exemption from the CSG has not been declared. This could be due to specific criteria not being met in the case of extreme weather events.

3. National CSG performance is a more accurate and reliable performance indicator

Variations in CSG extreme failure performance generally occur in parallel with increases and decreases in the percentage of orders completed within CSG timeframes. This is a simple statistical fact.

4. Extreme failure data is not used internally

Telstra does not use CSG extreme failure reports to manage its service delivery business. Given the very high performance levels outlined above, and on the understanding there will always be factors that lead to delays in connecting and restoring services, Telstra believes that extreme failure reporting serves no meaningful operational or regulatory purpose.

5. Obsolete FSA structure

The field service area (FSA) structure of CSG extreme failure reporting is also an artificially constructed one that reflects the arrangements of Telstra's Network Reliability Framework carrier licence condition. That is, it is simply driven by regulatory requirements and does not reflect customer demands or operational arrangements.

6. ACMA reported data

Extreme failure percentages published in the quarterly Telecommunications Performance Monitoring Data on ACMA's web site are so small as to be effectively meaningless and inconsequential to the vast majority of readers attempting to draw any conclusions from the data. By way of example, of the 12 extreme failure percentages published in the December 2006 quarter data, 10 were less than half of a per cent.

7. Competitive neutrality

The CSG is a national telecommunications industry standard that should be administered by ACMA on a fair and impartial basis. The application of onerous additional CSG reporting upon Telstra is inconsistent with the principle of best practice regulation of competitive neutrality.

Conclusion

CSG extreme failure reporting was introduced in response to the perception that orders not completed within CSG timeframes were not being actioned in a prompt manner.

From the subsequent results it can be concluded that this is simply not the case. CSG extreme failure reporting can no longer be justified based upon the fact that less than one per cent of both total CSG activation and assurance orders are classified as extreme failure events. The percentages are therefore so small as to be effectively inconsequential in attempting to draw any meaningful conclusions. It is an unnecessary cost burden on Telstra that fails any test of good regulatory administration and therefore should be removed.

K.5 Network reliability framework – level 3 related faults

Telstra's regulatory obligations in relation to the Network Reliability Framework are set out in clauses 24 to 27 of the Carrier Licence Conditions (Telstra Corporation Limited) Declaration 1997.

Clause 27 sets out the requirements in relation to monitoring, prevention, remediation and reporting at the CSG service level – known as Level 3 of the NRF.

A CSG service is deemed to have contravened Level 3 where it experiences:
- four or more CSG faults in a rolling 60 calendar day period; or
- five or more CSG faults in a rolling 365 calendar day period.

Each of the faults that have contributed to a CSG service contravening Level 3 is classified as a 'contravention fault'. Where a CSG service contravenes the above fault thresholds, Telstra must investigate the performance of the service and undertake what remediation is necessary to improve its reliability. At the completion of the remediation, the service is subject to an eight month monitoring period. A CSG fault that occurs during this period is referred to as a monitoring period fault (***MP fault***).

A MP fault must be reported to ACMA, together with sufficient information and Telstra's own assessment of whether the MP fault is a related fault, to allow ACMA to satisfy itself whether the MP fault is a related fault. Where a MP fault is assessed as a related fault, Telstra is required to re-examine its previous remediation activity and to carry out what further remediation is necessary to improve the reliability of the service. The monitoring period re-commences at the completion of this further remediation.

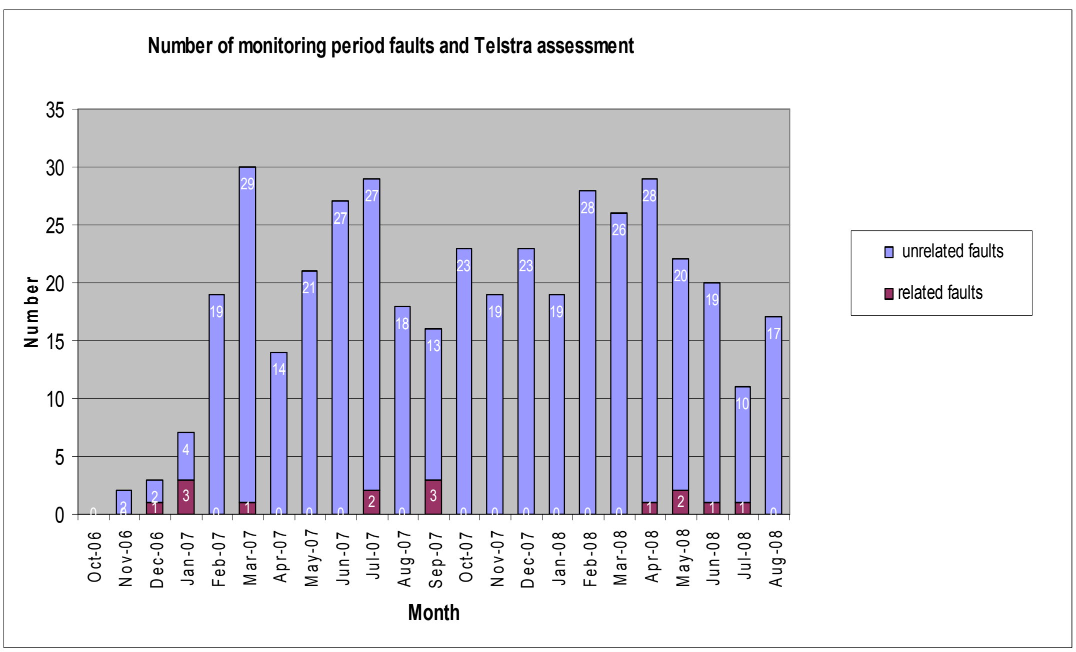
The concept of related faults (subsequent faults) has existed since the inception of the NRF. Telstra classified approximately 99% of such faults as unrelated and did not receive any queries from ACMA.

Since October 2006, Telstra has provided ACMA with 23 monthly monitoring period reports. These reports have generated extensive correspondence and consumed significant resources within both organisations – for a very small return on effort. The number of Level 3 contraventions has been relatively stable and low in number over a number of years.

Figure 6 below shows, over the same period, the total number of monitoring period faults each month and the number assessed by Telstra as being unrelated. The number accounts for less than 3 per cent of the total pool of CSG services in any given month.

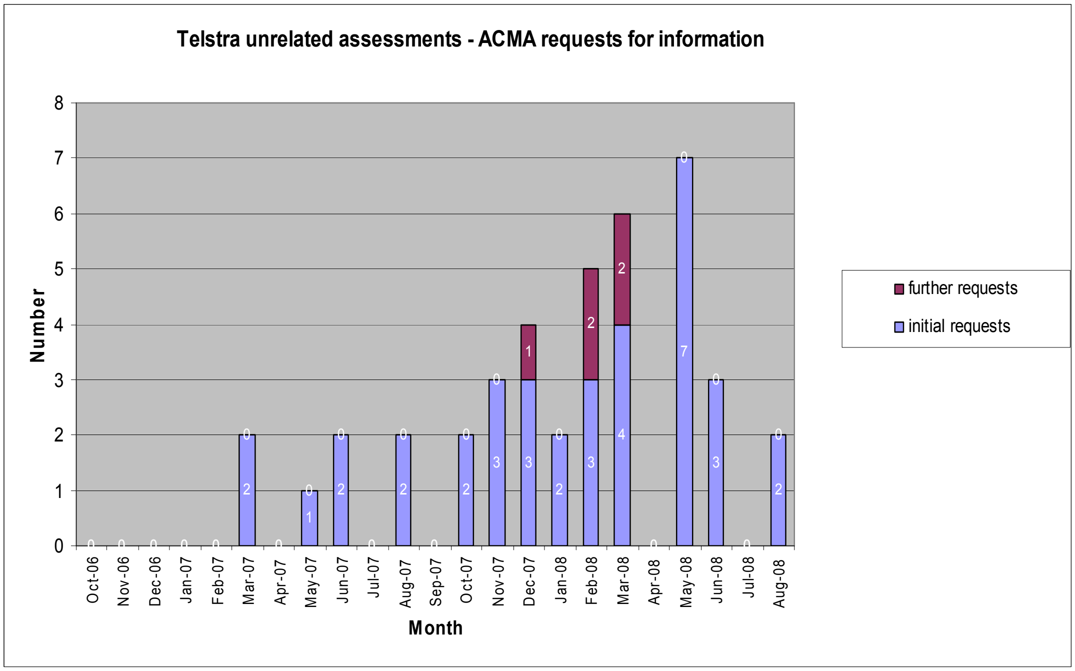
Importantly, Telstra has clearly indicated that over the long term very few monitoring period faults are found to be related to the previous remediation activity.

Figure 6



Despite this stable and consistent performance, ACMA in recent times has made a number of information requests of Telstra in relation to our assessment of unrelated faults in the monitoring period**.** Figure 7 below shows this increasing trend of regulatory compliance costs.

Figure 7



These on-going information requests are a classic example of red tape reporting and are a clear example of regulatory requirements being applied in a manner that simply generates a cost burden on industry participants like Telstra for no discernible benefit. *Not one substantive decision made by Telstra has been overturned by ACMA.* A single incident in March 2008 concerned a faulty telephone socket at the premises of a customer who had churned to Optus.

Telstra has recommended to ACMA that it move its extensive resources away from this approach of micro-management and numerous data collection/information requests.

Telstra has indicated to ACMA it should be assessing Telstra's compliance with the NRF provisions by ensuring Telstra has good processes and procedures in place, resulting in effective outcomes for customers.

To this end, Telstra, has developed and supplied to ACMA a detailed procedure document entitled '*NRF Level 3 Monitoring Period – Methodology for Assessing Related Faults'.* This document – Attachment 4 to this submission – was supplied in draft to ACMA in October 2008. In the absence of any comments, it was formally submitted to ACMA in November 2008. To date no feedback has been received from ACMA. In the meantime, ACMA continue to make numerous information requests.

Telstra recommends that ACMA adopt Telstra's procedure document for NRF level 3 monitoring.

L. CONCLUSION

In summary, the burden of regulation in telecommunications is immense and counterproductive. The most important implication – not just for regulated businesses in this sector but for the economic well-being of Australia as a whole – is the stifling effect of regulatory uncertainty and regulatory opportunism on investment in broadband infrastructure. Telstra also believes that the welfare costs of telecommunications regulation which is duplicative, inefficient and/or redundant are significant. Telstra urges the Commission to give focused attention to these issues and to consider the recommendations in this submission.

Telstra Corporation Limited
27 February 2009