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Optus Preliminary Submission

to the Productivity Commission's Draft Report

Telecommunications Competition Regulation

May 2001

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Introduction — overview

This paper is written as a preliminary response to the Productivity Commission's (the Commission) *Telecommunications Competition Regulation* draft report. Optus provides this preliminary paper to the Commission to provide an overview of our response to the draft report prior to the Commission's scheduled public hearing. Optus will provide more in-depth submissions to the Commission within its requested time frame.

In its draft report the Commission makes recommendations on the regulatory regime that should apply to telecommunications. Optus welcomes the Commission's draft report. It contains a comprehensive analysis of:

- The unique features of the telecommunications industry;
- The current regulatory regime; and
- Whether the current regime has been effectively implemented.

The Commission's draft report contains many recommendations that Optus supports. We support, for instance, the Commission's recommendation that the test for declaring services should be narrowed to capture only services subject to significant market failure in supply, rather than competitive facilities. Optus also supports the removal of retail price controls that cause an access deficit.

The Commission's inquiry represents a good opportunity to make recommendations that unlock competitive forces, enhance facilities-based competition and increase welfare through the removal of artificial barriers to entry — some of which have been created by government policy.

However, Optus also believes that there are some problems with the Commission's conclusions and the approach underlying them.

This overview provides:

- An outline of the problems with the Commission's approach;
- What this means for the Commission's recommendations;
- The issues we believe the Commission should focus on; and
- An outline of the structure of Optus' response.

The Commission's approach

While the Commission has done an impressive job analysing the telecommunications industry there are certain problems in the conclusions drawn from the analysis.

- The Commission's analysis seems to be premised on a belief that unless an industry exhibits a unique set of features, then general competition law should be relied on to regulate the anti-trust performance of the market. The Commission has rightly identified that there are unique features to telecommunications that require sector specific regulation. The Commission identifies these unique features as large sunk costs, network effects, the legacy of a historical statutory public monopoly, consumer switching costs and the existence of a vertically integrated carrier. However, notwithstanding its conclusion that such unique features exist, when the Commission makes its recommendations, it appears to revert to its premise that a general competition law framework is superior to industry specific regimes. We do not believe the Commission has put appropriate weight on the structural features it identified earlier, which leads to a 'disconnect' between the problems identified and the Commission's proposed recommendations, especially with reference to Part XIB.

- The Commission's approach to access pricing could be improved. The Commission focuses too much attention on the question of whether the Australian Competition and Consumer Commission (ACCC) has got access pricing right so that incentives to invest are preserved. The problem with this approach is that an examination of the data shows that access prices in Australia are high — Telstra has lost very little revenue or market share as a result of access regulation. The Commission's analysis also focuses too much on Telstra's incentives to invest and does not sufficiently examine the effect of access pricing on the incentives of new entrants to invest. In addition, the Commission does not fully flesh out its views on what Optus believes is the major problem affecting access pricing in Australia, namely the distorting effects of the retail price controls on access pricing and the incentives to invest.

- The Commission's report does not, in our view, spend enough time on key inhibitors to investment, innovation and competition. These key inhibitors include:

  - Retail price controls;
  - Barriers to entry erected by Telstra, such as a failure to properly provide local number portability for business lines;
  - Lack of non-discriminatory access to key pay-TV programming;
  - Barriers to new entrant build-outs such as local government charges on infrastructure not historically levied on Telstra;
  - Barriers to competitive entry and investment such as requirements that new, facilities-based entrants provide pre-selection and comply with the Customer Service Guarantee (CSG); and
  - A Universal Service Obligation (USO) policy that narrowly and inefficiently taxes competitive entry into telecommunications markets.

- The Commission's draft report makes certain recommendations which, if implemented, might well increase barriers to entry and lower competitive investment. For example, the Commission suggests removal of the economically superior "effect based" Part XIB test for dealing with Telstra's behavior, where Telstra misuses its market power in a manner that substantially lessens competition.

- The Commission's approach does not sufficiently recognise the interdependencies of 'regulatory levers' in telecommunications regulation. It does not, for example, clearly draw out the interdependency between retail price controls and reform of access pricing on the one hand, and incentives to invest on the other hand. Nor does it adequately acknowledge the interdependency between behavioural safeguards (embodied in Part XIB) and access regulation (embodied in Part XIC). In other jurisdictions a range of behavioral and structural safeguards complement general competition law and access regimes.[1] The same should apply in Australia.

- The Commission has sought to reopen a number of issues that have been well and truly settled by regulators both here and internationally. As the Commission recognises, there are costs to regulation. Optus believes that reopening issues which have been settled (such as pricing principles for number portability[2]) increases costs without delivering commensurate benefits.

What do these problems with the Commission's approach mean?

The problems outlined above lead the Commission to make some recommendations that we believe will increase barriers to entry, lower investment, harm competition and damage society's welfare. Most specifically, the Commission recommends general competition provisions to deal with behavioral problems and a movement towards one access regime for all utilities which draws on the principles in the proposed new Part IIIA.

Implications for Part XIB

Optus' major areas of disagreement with the Commission's recommendations on Part XIB are that:

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[1] Internationally, measures used to curb the telephony incumbent's market power have been significantly more interventionist than measures such as Part XIB. For example, there has been structural separation in the US and line of business restrictions in both the US, UK and Europe.

[2] Again with number portability, the key inhibitor of investment and innovation is Telstra's failure to adequately provide number portability for business lines. For example, for businesses with over 20 SIO's Telstra requires a "pre-porting study". Telstra then fails to provide any time frame for when the pre-porting study will be done, and or when the network upgrade will occur so that portability is provided to the business customer. Businesses require certainty and consistency of service, and Telstra's erection of these portability barriers prevent business customers switching their patronage to superior quality competitive carriers. This practice of Telstra's has enabled it to lose less market share in business fixed lines than in residential fixed lines. Telstra has also instigated poor transfer processes for providing residential number portability.

- Those recommendations are at odds with the unique anti-competitive problems the Commission identifies in its earlier analysis of the telecommunications industry. We do not believe the alternative remedies the Commission proposes should be used — declaration or s. 46 of the Trade Practices Act — would be effective in dealing with these problems[3]. Part XIB, for instance, is very effective in dealing with problems of switching costs.

- The draft report does not conduct sufficient analysis on the effectiveness of the alternatives it recommends to Part XIB. Our experience has shown that s. 46 of the Trade Practices Act is far less effective than Part XIB as a means of dealing with anti-competitive conduct in telecommunications.

- Part XIB represents an economic high-water mark in terms of the introduction of an effects-based test[4] for dealing with anti-competitive conduct. The ACCC has now developed significant institutional knowledge and expertise of enforcing Part XIB. Optus believes that proposals to abolish Part XIB, or to change institutional settings, represent an unfortunate retreat from the current high-water mark.

- The Commission incorrectly asserts that Australia is alone among developed economies in providing for effects based behavioural regulation as embodied in Part XIB. While different countries apply different degrees of behavioural and structural regulation, it is the international norm to mix sector specific access, structural and behavioral regulation. For example, European Union countries apply a range of behavioural and structural safeguards that operate along side access regulation and general competition law.

- The Commission says that there is no difference between the 'purpose' test under s. 46 and the 'effects' test under Part XIB. This ignores a number of problems with s. 46 that mean it is in fact quite a different test to the effects based test. The most obvious difference is that, under s. 46, if commercial reasons can be advanced for the conduct in question, then it will not be found to be anti-competitive. Further, the history of s. 46 cases suggests purpose is often not inferred from effect. We will provide more details on the differences between Part XIB and s. 46 in our further submission to the Commission.

[3] The Commission does not analyze whether or why Part XIC or s 46 would be better at dealing with the competitive problems that have been dealt with by Part XIB.

[4] Effects based test are regarded by economists as superior to "purpose based" tests because they focus on the economic harm or otherwise caused by the conduct at issue, in contrast to the moral purpose of that conduct. This is discussed by the Commission several times in the report including at pg XXVI.

Implications for Part XIC

We support much of the draft report's analysis on the declaration test under Part XIC, especially the proposal that declarations should target areas of significant market failure. There are, however, some problems with the Commission's recommended approach.

- The Commission has recommended a move towards an approach that relies more heavily on standardised access provisions. The Commission has drawn too heavily on the processes and declaration criteria the Commission proposes for its new Part IIIA. Such an approach may not lead to regulation targeted at the area and source of market failure. The Commission does not demonstrate any economic benefit from relying on Part IIIA type provisions. This recommendation is also at odds with the Commission's identification of unique features in telecommunications requiring sector specific, pro-competitive regulation.

- As with its s.46 analysis, the Commission has not demonstrated that the processes embodied in the proposed Part IIIA are more effective than the processes embodied in the present Part XIC. In actual fact, the current Part IIIA has been far less successful than Part XIC in opening up access to bottlenecks because it is complex, slow moving and subject to extensive legal appeal rights that can be used to frustrate access through delay.

- The test that the Commission has recommended for the declaration of services is overly complex and sets the bar too high for declaration of areas of significant market failure. The requirement that infrastructure be 'of significance to the national economy', coupled with the other requirements, will potentially allow the incumbent to successfully argue against the declaration of many currently declared services — including, for instance, unbundled local loop. This is despite the fact that unbundled local loops clearly exhibit the same bottleneck characteristics as the POTS local loop.

Changes we propose the Commission makes to its analysis and recommendations

We believe that the Commission should:

- Make some changes to its recommendations;
- Focus on some issues it has not focused on as much as it might have; and
- Refine some of its analytical approaches.

Recommended changes to major recommendations

Optus proposes that the Commission make the following changes to its major recommendations.

- It should recommend the retention of Part XIB. This is a complement to access regulation, is necessary to safeguard competition and it performs a role in stopping damaging anti-competitive conduct that the potential substitutes to Part XIB cannot perform. We note that the Commission recommends that one option is to retain Part XIB but modify it to work more effectively. We agree that modifications to Part XIB could improve its effectiveness, although we have some reservations about the actual modifications proposed in the report.

- It should continue to recommend a narrowing of the test for declaration. However, the proposed test is far too complex, is administratively cumbersome and is unlikely to ensure correct regulation of fixed local loop services. We therefore propose that the Commission should recommend a substantial market power test (SMP) to determine whether the owner of particular a network facility should be regulated. This SMP test is favoured in other jurisdictions such as in the European Community.

Major recommended area for analytical change

The major area where Optus recommends that the Commission change its analytical approach is that the Commission should take into account the incentives to invest of new entrants. As the draft report currently stands it is too "Telstra centric". Too much time is spent reviewing the ACCC's access decisions and extemporising on their effects on Telstra's incentives to invest. Later in this submission we provide evidence to demonstrate that the ACCC's access decisions, in so far as they relate to Telstra's incentives to invest, have been reasonable. They have preserved incentives to invest. We also provide evidence to demonstrate that access decisions regarding Telstra's bottleneck infrastructure and decisions under Part XIB have been vital for new entrant investment.

Major recommended areas for focus of Commission's work

The major areas where Optus recommends that the Commission change its focus are as follows:

- The Commission should pay more attention to the damaging effects of retail price controls on access pricing, investment and consumer welfare. Further, some of the recommendations on pricing principles will not work in the second best world in which there are retail price controls. Therefore, Optus believes that in its final report the Commission should:

  - Focus more attention on the retail price controls;
  - Examine the interdependencies between retail price controls and access pricing; and

  - Ensure that the recommendations that the Commission makes on pricing work in a second best world of retail price control.

- We also recommend that the Commission analyse further the impact on competition of issues such as the failure of local number portability processes, the lack of non-discriminatory access to key Pay-TV programming, the levying of the Customer Service Guarantee on new entrants and the USO.

The above are Optus' major responses to the Commission's recommendations. The Commission has made 25 recommendations and sought further comment on 25 topics. Optus provides specific comment on these recommendations and requests for information in the body of this response. We will also cover these issues in more detail in the final response we provide to the Commission.

Structure of Optus' preliminary response to the Commission's report

The structure of our preliminary response to the Commission's report is as follows.

Chapter 1 addresses the Commission's recommendations on Part XIB. It argues that the Commission should make recommendations consistent with retaining the provision.

Chapter 2 addresses the Commission's recommendations on Part XIC. It agrees with the Commission that the test for declaration should be narrowed. However, it argues that the Commission's proposed approach it too complex and cumbersome and lifts the bar for declaration too high. If implemented it could mean that areas where Telstra enjoys substantial market power are not subject to regulation. A substantial market power test may be superior to the Commission's current recommendations.

Chapter 3 examines the Commission's approach to access pricing. It argues that the Commission has dwelt too long on Telstra's access pricing, ignored the incentives to invest of new entrants and not sufficiently examined the implications of the retail price controls on access prices, incentives to invest, competition and consumer welfare.

Chapter 4 provides a response to the Commission's chapter on pay-TV, content exclusivity and regional telecommunications.

Chapter 5 provides a response to a range of the Commission's recommendations relating to issues such as number portability and preselection.

1. Part XIB

Overview of chapter

1.1 This chapter examines the Commission's draft approach to Part XIB. It argues that the Commission should not recommend abolishing Part XIB. Optus believes that there are flaws in the Commission's analysis, that Part XIB has been effective in addressing or deterring anti-competitive conduct and that the alternatives the Commission recommends to Part XIB (i.e. s. 46 and Part XIC) either would not work or would not work as effectively as Part XIB.

Overview of the Commission's points

1.2 The Commission makes the following major points about Part XIB.

(a) Part XIB should be removed or alternatively could be amended to modify its undesirable features and be made to work more effectively.

(b) There is a high risk of error in applying any regulation—in particular behavioural regulation as embodied in Part XIB.

(c) The efficiency gains from the use of Part XIB have been relatively low as it has lead to increases in distributional rather than productive efficiency.

(d) The competition notice regime risks discouraging pro-competitive behaviour and undermining incentives to invest.

(e) There have been few investigations under Part XIB, which calls into question its utility in stopping anti-competitive conduct.

(f) There are alternative remedies to Part XIB such as s. 46. The Commission concludes there is not much 'real difference' between the effects based test under Part XIB and the purpose based test under s. 46.

(g) Australia is alone in the world in incorporating an effects test, including likely effect, into its approach to anti-competitive conduct.

Optus' overall response to the Commission's approach

1.3 Optus believes that there are a number of problems with the Commission's approach and conclusions on Part XIB.

Commission has ignored its own paradigm on features of telecommunications

1.4 A major problem with the Commission's approach to Part XIB is that it appears to ignore many of the unique features in telecommunications that the Commission identified in chapter 2 of its draft report. The Commission has not sufficiently demonstrated in its analysis that Part XIB has failed to adequately

address these unique features or demonstrated that alternative remedies would work better.

1.5 The Commission identifies a number of unique features in telecommunications:

(a) High sunk costs;

(b) Network externalities;

(c) The legacy of a historic statutory public monopoly;

(d) High barriers to entry posed by high consumer switching costs; and

(e) The fact that vertically integrated carriers such as Telstra have an incentive to, and the capacity to, engage in anti-competitive behaviour like delaying access and not providing effective number portability.

1.6 The Commission has also said that telecommunications is characterised by a 'rapid pace of technological and market change' (p. xxiii). These unique features mean that while consumers demand 'real time' transfers, lower priced products and multiple, better quality services the incumbent is uniquely placed to slow down transfer processes, degrade a competitor's service and increase a competitor's cost base.

1.7 In Optus' view the combination of this rapid pace of change in telecommunications and the continuing market power of the incumbent, mean that a reliance on general competition law, as embodied in s.46, will harm economic efficiency. The key characteristics of Part XIB, which include the ability to rapidly respond to Telstra's anti-competitive behaviour, serve a useful purpose. We believe that the threat of Part XIB penalties dissuade Telstra from acting anti-competitively—Part XIB has an option value even when actions are not launched.

1.8 Optus believes that while the Commission has correctly identified unique features of the telecommunications industry, it has understated the effectiveness of Part XIB and overstated the possible effectiveness of other remedies in dealing with these unique features.

1.9 The local call resale case illustrates the value of Part XIB. In this case Telstra imposed on competitors terms and conditions for the churn of local call resale customers that were anti-competitive. These terms and conditions represent a good example of how the unique features of telecommunications were used to inflate competitors' costs and undermine competition.

1.10 The terms of supply of LCR inflated switching costs to a level which significantly reduced Optus' ability to win customers and enter various market segments. The switching costs Telstra sought to impose included[5]:

[5] Telstra originally sought to impose $50 customer switching fees in 1997.

(a) $30 switching fee for all customers in those instances where Telstra agreed not to forward customer debt to the gaining carrier;

(b) $15 switching fee for all customers where Telstra would forward customers debts incurred after a churn to the gaining carrier;

(c) The requirement to agree to take on an uncapped liability of customer debt incurred while the customer was still with Telstra;

(d) $7 rejection fee for all forms that Telstra rejected as incorrectly completed by the gaining service carrier's customer;

(e) The requirement for the customer to provide their Telstra account number (which most people do not know) to the new provider; and

(f) The requirement for customers to fill in a complex form which had been designed by Telstra.

1.11 The example above illustrates the draft report's arguments as to why switching costs in telecommunications can act as a barrier to competition.

(a) The draft report says that where a carrier has all the customers it has an incentive to raise switching costs. If switching processes are efficient, the incumbent will lose more customers than it gains. In this instance, Telstra had over 99 per cent of the local call market.

(b) The draft report says that switching costs can be a barrier where the role of intermediaries is limited. In this case all the processes associated with switching the customers were controlled by Telstra. It set the terms of churn, it designed and built all the systems into which other carriers had to interface, and it set time frames. In short, it was entirely a Telstra process and no intermediaries were involved.

(c) The draft report also identifies the ratio of the switching costs to the value of the services consumed as important in determining whether switching costs are a factor in limiting competition. In this instance, Optus estimated that Telstra's switching costs added an additional $22 million onto the business case, and 'put it under water' for many customers.

1.12 Optus believes therefore that the local call resale churn issue is a good example of the unique characteristics of the telecommunications market, and in turn the importance of Part XIB as a means of addressing anti-competitive conduct in this market. We believe a fuller analysis of Part XIB would have led the Commission to acknowledge this importance. We also believe that the Commission's analysis of the effectiveness of Part XIB is overly negative — it does not say anything about Part XIB's usefulness in addressing the unique issues in telecommunications but instead focuses on the expense of applying Part XIB, its speed of application and its effect on investment.

Commission analysis arguably supports retention of Part XIB

1.13 We believe that the Commission's analysis of the effectiveness of Part XIB, and its associated recommendation to abolish Part XIB, could in fact be used to support quite the opposite conclusion — namely Part XIB's retention.

1.14 This is so for the following reason. The Commission sets up an analytical framework in which it identifies two types of errors which could be made:

(a) Type 1 errors—which are classified as an over use of competition notices and involve the Commission issuing competition notices for behaviour which is classified as harmfully anti-competitive when it isn't (p 5.1.)

(b) Type 2 errors—which are classified as an under use of competition notices where the harmful anti-competitive behaviour is overlooked or competition notices are not issued when they should be (p 5.1).

1.15 The Commission says that quantifying the benefits and costs of regulatory intervention including the risk of type 1 and type 2 errors is very difficult. However, the Commission's conclusions indicate it believes it is more likely that type 1 rather than type 2 errors have been made. The Commission says at page 5.39, "the effects or likely effects test merely by reason of its more expansive nature widens the scope for the ACCC to conclude that anti-competitive conduct is occurring and thus increases the likelihood of type 1 errors".

1.16 The existing evidence, however, tends to suggest that type 1 errors have not been made. The evidence includes the following points:

(a) As the Commission itself notes there have been "few" competition notices issued. If type 1 errors were a serious problem one would surely expect that more competition notices would have been issued.

(b) The competition notices issued did cover harmful anti-competitive conduct and would have been found to be harmful by the courts. In the case of the internet competition notice, for instance, court proceedings were commenced. Optus believes that the reason Telstra altered its behaviour and signed a peering agreement with Optus was that it became clear that the Court viewed Telstra's conduct unfavourably. We believe this demonstrates that Telstra was concerned that the Court would find that its internet interconnect arrangements with peer network were anti-competitive.

1.17 In addition, we do not believe that the Commission can quantify any harmful "behavioural modification" effect that the existence of Part XIB may have had on Telstra.

1.18 Indeed, as we mentioned above, it is equally probable that the ACCC has made type 2 errors and not issued competition notices for harmful anti-competitive conduct when it should have. This is because the institutional and legal

structures make it easier to make type 2 errors than type 1 errors. To make a type 1 error there must be *two* cumulative institutional errors:

(a) The ACCC must conclude that there is anti-competitive conduct when the conduct is not anti-competitive; and

(b) A court must similarly conclude there is anti-competitive conduct when in fact there is not anti-competitive conduct.

However, in order to make a type 2 error only *one* institutional error is needed — either the ACCC, or a court, concludes that there is no anti-competitive conduct when in fact there is. In Optus' view there therefore is a lower threshold to making type 2 errors than type 1 errors making it more likely type 2 errors have been made.

1.19 Institutional factors further buttress Optus' view. Our experience has been that the ACCC takes a cautious or even 'risk averse' approach to Part XIB action, as it does not want to initiate proceedings unless it is very sure it can win such an action in the Federal Court. In contrast, the damaged to the ACCC of making a type 2 error is often minimal, due to the non-transparency of the anti-competitive behaviour to the wider public.

1.20 It may be argued that the threat of pecuniary penalties means that Telstra will cease its conduct even if it believes that it is not anti-competitive. This would mean Telstra may cease its conduct once the competition notice has been issued but prior to court proceedings. This would increase the chance of a type 1 error. However, there is *no* evidence to suggest that when Telstra is confident of its case it does not exercise its full legal rights. With the local call resale churn issue, for instance, Telstra 'held out against' the ACCC's competition notices for months. In the end it settled the case with some slight amendments to its behaviour and a $4.5 million 'fine', when it potentially faced court fines of hundreds of millions of dollars for breaching the Act.

Commission has not sufficiently compared and assessed alternative remedies

1.21 The Commission says that there are more effective remedies than Part XIB, such as s. 46 and Part XIC. However, a problem with this view is the Commission has not demonstrate that these are more effective remedies to Part XIB. It does not provide adequate evidence for this claim. Instead, the Commission's comparison between Part XIB and s. 46 focuses on outlining the different tests between Part XIB and s. 46.

1.22 In fact, there is clear evidence that Part XIB is faster and more effective than the alternatives such as injunctions and proceedings under Part IV.

(a) The threshold for Part XIB action is lower than for injunctive proceedings—meaning that the ACCC can act more quickly under Part XIB than it could under Part IV proceedings;

(b) The substantial pecuniary penalties under Part XIB provide a degree of deterrence that is not available with an injunction or ordinary Part IV proceedings; and

(c) The regulator is able to continue to "build its case" between issuing a Part A notice (which has no evidentiary effect) and issuing a Part B notice (which constitutes prima facie evidence of a contravention) which it cannot do in ordinary Part IV proceedings. This provides the ACCC with a degree of flexibility and enables the ACCC to 'calibrate' its regulatory response in a way which it could not otherwise do.

1.23 We believe the Commission should further analyse the effectiveness of s. 46. This is important because in our experience s.46 is a much slower, less effective mechanism for addressing harmful anti-competitive conduct. Optus presently has on foot proceedings against Telstra under s.46. We attach at appendix 1 an outline of how long these proceedings are taking. They have already been going for more than three years, with discovery of between 25,000 and 30,000 documents. It is hardly surprising therefore that we believe s.46 is slower, more complex and more onerous than Part XIB.

1.24 The Commission has also suggested that Part XIC could have been used to address the issues which were dealt with under Part XIB. It is, however, doubtful that Part XIC could have been used to address the local call resale churn processes or the internet problem. In particular, no internet service is declared under the current Part XIC declaration criteria and it is not likely such a service would be declared under the tighter criteria proposed by the Commission. It is unlikely a commercial churn service could be declared under the Commission's proposed declaration criteria.

International and industry precedents are incorrectly stated

1.25 The draft report says that, "of these countries Australia alone explicitly incorporates an effects test including likely effects, devoid of purpose into its approach to anti-competitive conduct regulation of telecommunications markets" (p 5.13). In response to this Optus believes:

(a) The Commission does not sufficiently take into account the fact that other jurisdictions rely on behavioural safeguards that operate alongside general competition law and access regimes. For example, in the European Union there are behavioural provisions in relation to cross-subsidies, prior notification of network changes and prohibitions on bundling. An effects based competition test similar to the one used in Part XIB has been part of US jurisprudence since the passage of the Sherman Act.

(b) The Commission also ignores the fact that there is far more rigorous structural separation in the telecommunications industry in other jurisdictions — and indeed in other industries in Australia. This means that the mix of access regulation and behavioural regulation is different:

i) In the US the local loop is separated from long distance carriers. The local companies also had historical line of business restrictions preventing entry into cable TV and mobile services.

ii) In the UK and Canada there is rigorous accounting separation of bottleneck and non-bottleneck facilities. The UK incumbent also had line of business restrictions on entry into cable TV.

iii) In gas and electricity in Australia there is vertical separation of local distribution and transmission networks.

1.26 The Australian telecommunications regime is significantly more light-handed than in other jurisdictions. Rather than preventing Telstra from entering the markets through line of business restrictions, the Australian regime merely prevents Telstra cross-leveraging use of market-power, arising from its historical monopoly position, in an anti-competitive manner.

1.27 It is important that the Commission's analysis and recommendations recognise that other jurisdictions do rely on behavioural regulation, and further that the extent to which behavioural regulation needs to be relied upon depends on the extent to which structural separation and other safeguards are in place. The Commission should recognize that Telstra is subject to some of the most light handed structural regulation in the world and this means it is necessary to have more rigorous behavioural regulation.

Arguments on distributional and efficiency effects are misplaced

1.28 The Commission has said that it believes that the actions taken by the regulator under Part XIB to date have only advanced distributional efficiency. The Commission says that "even where action is correctly taken against anti-competitive conduct, the efficiency gains may be relatively low—much of the benefit is distributional" (p 5.1). It says that there have been limited efficiency gains particularly where elasticity of demand is low.

1.29 The problems with the Commission's analysis on this point are:

(a) No evidence is provided to support the proposition that the effects of Part XIB action have only been distributional.[6]

(b) It does not provide evidence to support its view that the services covered by the competition notices issued to date have low elasticities of demand. In fact, the elasticity of demand for internet services is quite high.

(c) There is significant evidence to demonstrate that action under Part XIB has led to increased competition, lower long-term prices and increased societal welfare. For instance, the prices offered under Optus' Spinnaker product have fallen by more than half in the last six months. We will provide the Commission with detailed data on these price falls. We will

also demonstrate that such price falls — and efficiency gains — could not have happened without the ACCC's Part XIB action on internet interconnection for peer networks.

Ignores incentives to invest of other players

1.30 The Commission quotes at some length Telstra's arguments that Part XIB has a dampening effect on incentives to invest. In Optus' view, the Commission has been too Telstra-centric in its assessment of the negative impact of regulation on incentives to invest.

1.31 In fact Part XIB has had quite the opposite effect on the incentives to invest of new entrants. This is clear from the internet interconnection case. In this case, Optus was proposing to spend $20 million building a state of the art ATM transmission network to carry data and interconnection traffic. However, this network would have been unviable without a peering arrangement with Telstra. Optus was only able to come to such a peering arrangement because of action by the ACCC under Part XIB.

1.32 We will provide details of the economics of this network and the way in which the competition notice enhanced incentives to invest by non-Telstra players.

2. Telecommunications access, scope and rationale

Introduction

2.1 This chapter addresses the Commission's views on the rationale and scope of telecommunications access, as outlined in Chapter 8 of its draft report.

2.2 We outline areas of agreement with Commission's recommendations on access holidays and a stricter test for declaration.

2.3 We also outline areas of the Commission's analysis that could be further refined. In particular:

(a) The Commission's declaration test does not sufficiently focus on the principal source of market failure in telecommunications, fixed local loop services. This means the Commission's proposed declaration criteria may lead to a scaling-back of access regulation in the area where it is most needed — fixed local loop services.

(b) A substantial market power test may better capture the area of market failure where declaration should apply for fixed local loop services.

The Commission's draft position on the rationale and scope of telecommunications access regime

2.4 In examining the rationale and scope of the telecommunications access regime, the broad conclusion the Commission has made is that the scope of declaration should be narrowed, with stricter tests for declaration. In particular, the Commission makes the following points in Chapter 8 of its draft report:

(a) There is a good case for an access regime to apply to telecommunications.

(b) With appropriately set access prices, such an approach is more likely than other measures to increase efficient competition in final markets with dynamic gains, such as more pressure on incumbent costs, innovation and greater product differentiation.

(c) The current objects test (LTIE) should be broadened to encompass overall economic efficiency, consistent with the Commission's proposal for Part IIIA. The Commission argues that this would maintain consistency between the generic and the specific access regime and remove possible ambiguity.

(d) The declaration criteria in Part XIC are vague and provide excessive discretion to the regulator. They also differ from those applying in Part

IIIA. The Commission recommends that the criteria be replaced with a new more objective set of requirements, all of which must be met, before the ACCC can declare telecommunications services.

(e) For a telecommunications service to be declared it must meet all of the following criteria:

i) the telecommunications service is of significance to the national economy and

- for a service used for originating and terminating calls, there are substantial entry barriers to new entrants arising from network effects or large sunk costs; or

- for a service not used for originating and terminating calls, entry to the market of a second provider of the service would not be economically feasible;

ii) no substitute service is available under reasonable conditions that could be used by an access seeker;

iii) competition in downstream markets is insufficient to prevent the provider of the service from exercising substantial market power;

iv) addressing the denial of access, or the terms and conditions of access, to the service concerned is likely to improve economic efficiency significantly; and

v) access (or increased access) to the service would not be contrary to the public interest.

(f) There are grounds for modifying Part XIC to allow the ACCC to grant an immunity from subsequent declaration to new telecommunications investments that would not occur if there was a threat of declaration (an access holiday). The Commission is seeking feedback on how such an access holiday could be implemented effectively.

(g) Price monitoring may be a more light-handed alternative when seeking declaration or revocation of declarations for telecommunications services, but it also risks an additional layer of regulation. The Commission seeks feedback on its use.

(h) Once a service is declared all carriers providing the service should be subject to the declaration, unless they have secured a specific exemption from the ACCC or have acquired a prior access holiday.

(i) Currently, declaration has no sunset provisions. These should be introduced.

Optus agrees with much of what the Commission has recommended

2.5 Optus agrees with much of what the Commission has recommended. We agree that:

(a) An economic efficiency test should replace the long term interests of end users (LTIE) test;

(b) The declaration test should be tightened;

(c) Access holidays should be granted for prospective marginal investments and / or where the investment opportunity is contestable; and

(d) The fixed local loop and associated services and infrastructure are major areas of significant market failure.

Economic efficiency should replace LTIE

2.6 Optus agrees with the Commission's proposals to replace the LTIE with an economic efficiency test that attempts to maximise social welfare. Excessive focus on end-users, rather than the aggregate of consumer and producer surplus, can result in regulatory decision-making that attempts to produce short-run consumer gains at the expense of long-run efficient investment and innovation.

2.7 The economic efficiency test should place emphasis on the role of competition in promoting economic efficiency. As discussed in chapter 4 of this submission, other countries have achieved a superior facilities-based competitive dynamic to Australia. This has been achieved through encouragement of facilities-based entry, structural separation and line of business restrictions on incumbent local phone companies, and behavioral safeguards to promote facilities-based entry.

2.8 Competition, in contrast to a singular focus on static productive efficiency, is the principal economic method for promoting dynamic economic efficiency. This is because of the powerful forces that are set in motion by the incentive and reward structure created by competitive markets. In real world competitive markets, new entrants must offer customers something of value to entice them to shift their patronage from the incumbent. The incumbent supplier, in turn, must offer something of value to entice them to stay. As a result, customers benefit from the growth in interfirm rivalry that accompanies the evolution of competition. Moreover, with competition, the gains reaped by consumers and society more generally, can be shown to exceed the losses of the former monopolist.

2.9 In summary, the promotion of competition should be an explicit objective of the economic efficiency goal.

Declaration test should be tightened

2.10 Optus also agrees with the Commission recommendations that the current Part XIC declaration criteria are somewhat vague. The ACCC has interpreted, in some instances, these criteria in a way which has meant that mandated access has been applied to competitive services and areas where there is no evidence of significant market failure. The Part XIC regime has been unnecessarily extended to infrastructure services subject to competitive supply including:

(a) Intercapital city transmission[7];

(b) Mobile origination and termination; and

(c) Cable delivery of analogue subscription TV services.

2.11 While it is difficult to pinpoint the precise basis for this regulatory failure, the vagueness and the wide discretion afforded the regulator in the declaration test may have contributed to the excessive reach of the access regime.

Access holidays for prospective marginal and contestable investments

2.12 Optus supports the granting of access holidays for prospective marginal investments and/or where the investment opportunity is contestable. In such instances competition over the investment opportunity is the appropriate means to regulate of prospective commercial returns.

2.13 Our experience has been that the access regime has, without economic basis, extended to ex-post-successful investments. It has even been applied to where there is competition and returns are not high—for example, analogue cable TV delivery. In this industry capital investment requirements are high, and as the financial results of all pay-TV carriers demonstrate, returns are negative even in accounting terms, let alone economic terms.

2.14 Regulators may suggest they will exercise discretion and abstain from regulating activities that will ex-ante provide an, on average, normal return. Our experience has been that there is a tendency for the regulator to extend regulation ex-post where demand conditions turn out to be more favorable than expected, and there is a perception of ex-post above normal profits. This can occur even where it is clear there has been no significant market failure.[8]

2.15 A classic example of the possibility of this outcome is in the mobiles industry. Mobiles was ex-ante contestable, therefore the ex-ante expected returns are normal. Nevertheless the ACCC has been conducting a two-year inquiry into whether to price regulate mobile interconnection charges, notwithstanding the total returns earned by mobile operators are, at best, normal. The only

[7] Superfluous access regulation has occurred in this area. The ACCC declared inter-capital transmission in 1998, has had no arbitrations, and is now in the process of revoking the declaration. The original declaration was not based on any economic logic.

[8] In other instances the regulator has shown a tendency to also regulate those marginal investments that have ex-post earned less than normal returns such as cable TV delivery.

economically interesting issue concerning whether there is a need for access regulation in this instance is whether the ACCC is capable of structuring charges for the components of mobile service in a more Ramsey efficient[9] manner than those currently levied by the mobile operators themselves.

Fixed local loop is a major area of market failure

2.16 Our experience has been that a major area of significant and perennial market failure is the fixed local loop owned by Telstra. This is because of:

(a) The large fixed and sunk costs associated with replicating the investment;

(b) Network effects and switching costs;

(c) Natural monopoly cost characteristics.

(d) Government erected barriers to entry, such as:

i) the application of a tighter set of environmental planning laws now than applied when Telstra rolled out its network; and

ii) Local councils attempting to discriminatorily levy charges on new entrant networks.

(e) Retail price controls which result in Telstra pricing basic access infrastructure below cost, with the bizarre result that Telstra has a Government mandate to predate in response to facilities-based new entry.

2.17 The telecommunications access regime should be designed to ensure that it captures this area of significant market failure that includes the fixed local loop and associated services. However,—as Optus discussed in its appearance before the Commission's earlier—it would be unwise to specify that regulation *only* apply to the local loop.

2.18 It is important that the regulator has some discretion to apply declarations to all services subject to significant market failure. It is unclear what services will be subject to the significant market failure as technology is continually finding ways of providing new services over the local loop and associated infrastructure. Optus does not, therefore, favour a test that explicitly says it is targeted at the local loop. We say the test should be tight enough to capture the local loop but sufficiently flexible to capture the plethora of services that do, and are likely to, run over the local loop and associated infrastructure now and in the future.

[9] The efficient pattern of prices would need to properly account for the super-elasticities associated with the demand interdependence between subscription and call charges. Lower subscription charges cause higher mobile take-up leading to higher call demand and improved attainment of scale economies.

The dangers of ignoring the characteristics of the telecommunications market

2.19 As discussed, Optus agrees with the thrust of much of the Commission's analysis of the rationale and scope of the telecommunication access regime. However, we believe that the Commission is in danger of an over-reliance on utilising the general access provisions of its proposed Part IIIA, and needs to refine its suggested approach.

Access regime needs to focus on fixed local loop market failure

2.20 The Commission's draft report correctly discusses the special features of telecommunications markets including:

(a) Network effects;

(b) Natural monopoly cost characteristics;

(c) Production interdependencies amongst competitors;

(d) Switching costs; and

(e) The large sunk costs of entry and duplicating fixed local loop services.

2.21 The Telstra fixed customer access network and associated services are major areas of significant market failure in the telecommunications industry. Telstra retains 95 per cent of the fixed local loop connections, and 90 per cent of the revenue from these lines. While the market was opened to full facilities-based competition in July 1997, Telstra's market share of local loop services and revenues has diminished slowly. The market is, and will remain in the foreseeable future, very highly concentrated and dominated by Telstra.

2.22 The market failure in fixed local loop services is caused by the special economic characteristics of the local loop discussed in the Commission's report.

Commission's test is complex and sets the bar too high

2.23 A danger is that in attempting to homogenise access regimes across industries, a more generic competition paradigm is achieved at the expense of a tighter focus of the telecommunications access regime on a major area subject to significant market failure — the fixed local loop. The telecommunications access regime should be specifically targeted at this principal area of market failure.

2.24 The Commission suggests different tests for originating and terminating services than for other services. However, Optus believes that the proposed declaration hurdle for such originating and terminating services is too high and does not properly account for the special economic characteristics discussed by the Commission.

2.25 A preferable economic test for services subject to significant market failure, consistent with other sections of the TPA[10] and international approaches[11], is the following:

> *The ACCC may only declare a service that originates and or terminates electronic communications where satisfied the supplier of the service has a substantial degree of power in the market in which it is supplying the service.*

2.26 Fixed local loop services, for instance, should not have to satisfy other onerous competition tests to qualify for declaration, such as the tests (b), (c) and (d) proposed by the Commission.

2.27 As presently worded, the Commission's recommendations may lead to a relaxation of pro-competitive access measures in the major area subject to significant market failure, while applying access regulation in areas not subject to market failure such as new entrant networks. For example, under the Commission's proposed declaration criteria the access regime might well not apply to:

(a) Unbundled local loop services (ULLS);

(b) Line sharing services; and

(c) Local call resale services.

2.28 These are currently critical services of the local loop which are subject to significant market failure, and which the telecommunications access regime needs to target. Removal of such regulation would put Australia significantly out of line with the advanced pro-competitive economic policies pursued internationally by the OECD's best performers.

Commission's proposed regime may not apply to ULLS

2.29 The Commission's proposed declaration criteria may not lead to the access regime applying to ULLS for the following reasons:

(a) The downstream services reliant on ULLS are still in developmental stages and therefore the ULLS may not yet be regarded as significant to the national economy;

(b) Since ULLS is often used exclusively for data services and not calls, it would need to satisfy the Commission's proposed economic non-duplication test (a 2). In certain areas, such as the Optus HFC cable, the entry of other carriers providing high-speed data services has occurred. Therefore test (a 2) is unlikely to be satisfied.

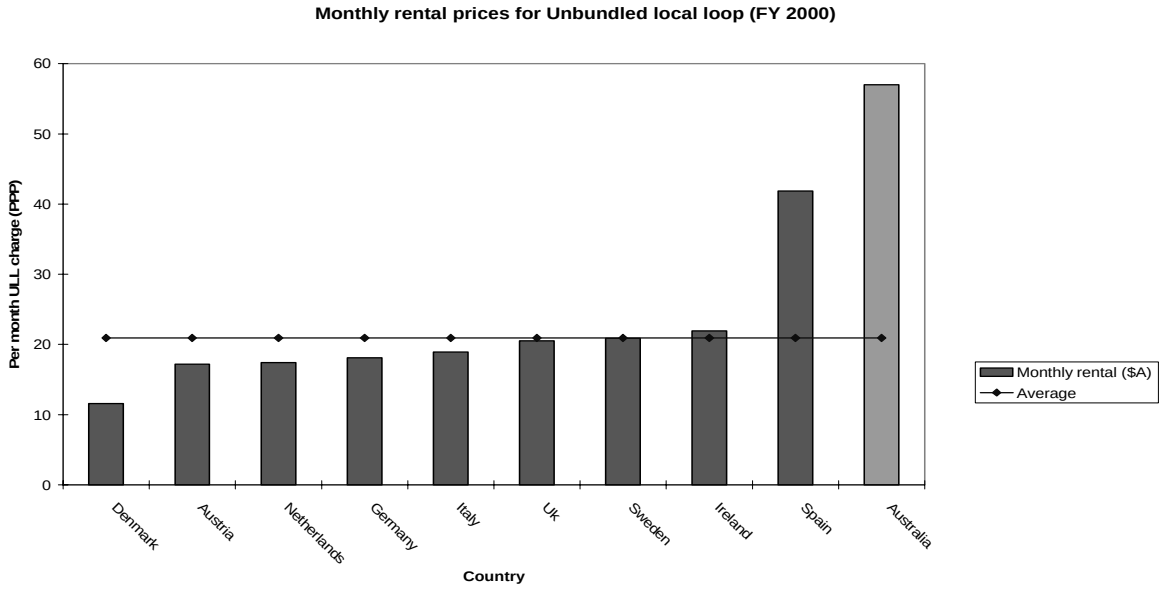
[10] Remedies under Part XIB and Section 46 only activate where the supplier has a substantial degree of market power.

[11] EU law requires telecommunications providers to have significant market power, generally defined as at least 40 per cent market share, before being subject to regulatory determined conditions of interconnection access.

2.30 The winding-back of ULLS declarations would be contrary to all international economic policy in this area. Governments in both the US and Europe are moving to more pro-actively regulate this service and have set prices at $20 per month as shown in the following graphs.

2.31 The average price of renting wholesale DSL loops in Europe set by regulation is AUS$21 per month, which is 170 per cent below Telstra's proposed price of $57 per month. This is shown in Chart 2.1.

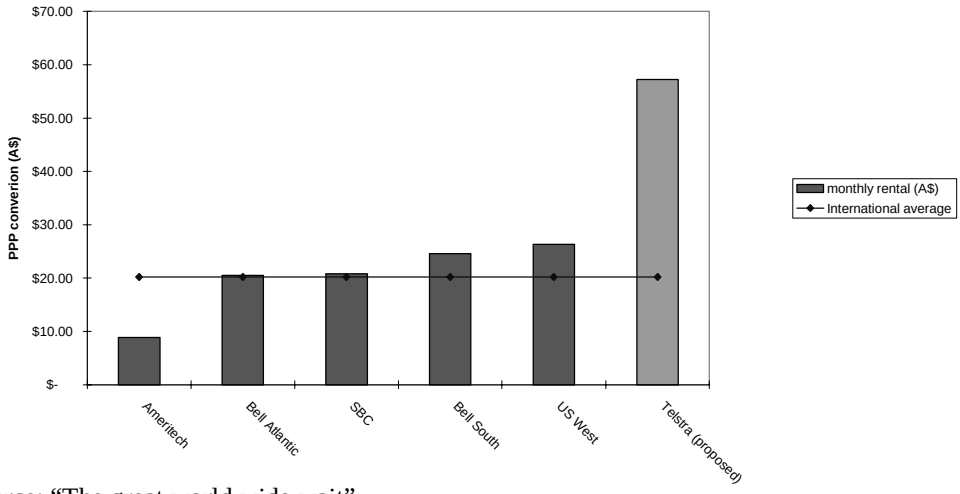
Chart 2.1: European monthly line rental prices for wholesale DSL



Source: Analysis tariff data: http://www.analysis.com/atlas/series/LLUB.as

2.32 Telstra proposed ULLS prices are also excessive by US standards, as shown in the graph below which compares Telstra's prices for wholesale DSL in metropolitan areas to prices charged by Incumbent Local Exchange Carriers (ILEC) across 49 States of the U.S. The average line rental price across these ILEC's is $20.21 per month. By contrast, Telstra's prices are 182 per cent above this average price.

Monthly ULLS rental in metropolitan US states compared to Telstra



Source: "The great world wide wait"

http://www.internettelephony.com/archive/1.44.99/cover

2.33 The ACCC proposes ULLS prices of approximately $40 per month, are still 100 per cent above the international average. Attachment 2 to this submission, taken from Communications Outlook 2001, outlines the local loop unbundling requirements in OECD countries:

Commission access regime may not apply to line-sharing

2.34 Regulators in both the US and much of Europe require incumbent telephone providers to supply line-sharing of the local loop — renting the high-speed portion of the loop to the new entrant at a discount from the full ULLS price. In contrast, in Australia there is no mandated requirement to provide line-sharing services. Telstra's proposed wholesale price for a line sharing service is $90 per month. This is higher than the wholesale price for full ULLS ($40 per month set by the ACCC), and higher than Telstra's own retail prices for ULLS high-speed internet services ($60–$80 per month). Hence, Optus believes Telstra is attempting to foreclose downstream entry into high-speed data services and monopolise internet access to homes and businesses through this pricing structure.

2.35 Under the Commission's proposed declaration criteria, line sharing may not be able to be declared for the same reasons applying to ULLS. Line sharing is not a call service and may not be regarded as either significant to the national economy or satisfy the Commission's non-duplication test. Again such a policy outcome would lead to a prospective relaxation of fixed local loop regulation.

Local call resale services

2.36 The proposed declaration criteria outlined by the Commission would likely mean that local call resale (LCR) was not captured. When coupled with the Commission's other recommendation that Part XIB be revoked, this would mean that competitors to Telstra would be hit with a 'double blow':

(a) It is unlikely they would be able to get access to the service on reasonable price terms as it would not have been declared; and

(b) It is unlikely they would be able to obtain a rapid and effective remedy for anti-competitive conduct on any non-price terms as Part XIB would not exist.

2.37 Local call resale is unlikely to be declared under the Commission's proposed approach because LCR is an end to end communications service and is not specifically "used for originating and terminating calls". Therefore, if LCR did not come under the remit of the Commission 1(a) test it may need to satisfy the 1(b) duplication test. This would again be unlikely to be satisfied given the Optus HFC network roll-out. In addition, there is doubt over whether the LCR customer transfer process would satisfy the "of significance to the national economy" test proposed by the Commission.

2.38 Further, as mentioned in chapter 2 and above, without Part XIB, competitors would not be able to address anti-competitive conduct associated with the supply of local call resale (see page 13 for a description of this type of conduct).

Summary of Optus' views on the telecommunications access regime

2.39 Given the special features of telecommunications, which give rise to market failure in the fixed local loop and associated infrastructure and services, the access regime needs to be fashioned to focus on this area of market failure.

2.40 The generic declaration principles suggested by the Commission may not sufficiently target regulatory access measures towards this major area of market failure. Internationally, telecommunications access regulation has focussed on opening markets to competition via the promotion of:

(a) Facilities based entry;

(b) Purchase of unbundled incumbent network elements combined with new entrant facilities; and

(c) Resale of incumbent network services.

2.41 The telecommunications access regime in Australia should similarly attempt to promote all these forms of competitive entry into the provision of fixed local loop services. A declaration test, where the ACCC can only declare a service when it is satisfied that the provider has a substantial degree of market power in supply of the service, is preferable to the generic tests proposed by the

Commission. Such a test more directly targets the area of market failure that requires pro-competitive government stimulus.

2.42 Optus understands the Commission has sought comments on each aspect of its proposed declaration test. We will provide these at a later time.

3. Access pricing

3.1 This chapter examines the Commission's approach to access pricing. It argues that the Commission has needlessly dwelt on Telstra's access pricing, ignored the incentives to invest of new entrants and not sufficiently examined the implications of the retail price controls for access prices, incentives to invest, competition and consumer welfare

The Commission's position on access pricing

3.2 The Commission addresses access pricing in Chapter 10 of its draft report. Its views can be summarised as follows:

(a) Access pricing is important to telecommunications, primarily because it affects the extent to which investment in, or the use of, telecommunications facilities is efficient;

(b) The Commission would like access pricing principles to be legislated to remove discretion from the ACCC and to increase guidance to negotiating parties;

(c) The Commission is concerned that access prices may have been set too low by the ACCC, but is unable to draw any firm conclusions due to the complexity of cost models;

(d) Following on from this uncertainty about the level of access prices, the Commission believes the ACCC should err on the high side;

(e) The Commission believes that non-dominant operators can enjoy market power;

(f) Price controls on Telstra lead to an access deficit which distorts access prices — the Commission believes price controls should be reformed to eliminate the access deficit;

(g) Costing methodologies such as TSLRIC are complex, and the Commission would like to see simpler methodologies such as CPI-X utilised once TSLRIC has been used to set a base; and

(h) The ACCC's degree of public disclosure could be improved. [12]

Optus' response to the Commission's position

3.3 Optus' overall response to the Commission's suggestions about access prices is that some of the suggestions would have merit on the assumption that all of the

[12] Productivity Commission, 2001, Telecommunications Competition Regulation, p. 10.1

Commission's recommendations were implemented as a package of reforms. For example, the Commission's suggestion to legislate access pricing principles may have merit if retail price controls on Telstra have been lifted, and if the Commission's suggestions about narrowing the scope of declaration were implemented.

3.4 However, if retail price controls remain in some form, and/or if the scope of declaration remains inappropriately broad, then public policy is in a world of second best. Once in a world of second best, optimal policy making demands that policy must note the constraints in operation and frame policy accordingly. Ignoring constraints, and suggesting "first best policy solutions" in a second best policy context risks reducing consumer welfare and making outcomes worse.

3.5 This concept is explained by Ng (1979):

> *…the theory of second best says further that, by trying to satisfy as many (short of all) conditions as possible, it is by no means certain that we will not in fact make matters worse…*
>
> *In economic terms, this means that the second-best conditions depend not only on the values of (ratio of) marginal costs and marginal rates of substitution, but also on the degrees of complementarity or substitutability between goods in the constrained sector and those in the free sector, and the effects of increased production of a good on the marginal costs of another. This involves tremendously more complicated information than what is related to the first-best conditions.* [13]

3.6 Access pricing is an important aspect of telecommunications. However, it is important to discuss access pricing with direct reference to the retail price controls that distort access prices and investment decisions in the telecommunications market. Every current access price the ACCC has set is distorted by retail price controls. For example, PSTN originating and terminating charges are 45 per cent above the ACCC estimate of TSLRIC due to the "access deficit". Local call resale discounts are less than those arising under an avoidable cost (ECPR) methodology because of Telstra's claimed "local services" deficit. The existence of retail price controls distorts market behaviour, and immediately places the regulator in a "world of second best".

3.7 In the world of second best, if the Commission's proposals to remove retail price controls are not implemented, then the legislated pricing principles that assume first best conditions will make equilibrium outcomes worse. For example, where retail controls hold the price of services below cost, a legislated access pricing rule that requires access prices to recover costs necessarily worsens equilibrium outcomes because it prevents downstream competitive entry and is inconsistent with Efficient Component Pricing.

[13] Yew-Kwang Ng, 1979, Welfare Economics — Introduction and Development of Basic Concepts, pp. 222–223

Current price control arrangements in Australia

3.8 Many of the finer methodological issues around costing approaches are insignificant when compared to the important issue of retail price controls.

3.9 Retail price controls are the biggest barrier to competition in the telecommunications industry. This is because the retail controls hold the price of core infrastructure $1 billion per annum below costs, according to ACCC modeling. This reduces the economic incentives for competitors to undertake investment in fixed loop infrastructure. In addition, the controls establish costless incentives for Telstra to predate in markets where they are subject to competition. The high X value in the controls causes the price of Telstra's local and long-distance services to be driven to predatory levels through time. These factors deter new entrant investment in fixed local loop services.

3.10 Australia's policies in relation to retail price controls is discussed in the Productivity Commission's March 1999 Report, *International Benchmarking of Telecommunications Services*.

3.11 The Commission ranked countries from best to worst performing in terms of pricing performance. When the results of this benchmarking study are married against those countries that have retail price controls and those that do not have such controls, the countries that have performed best are those with the least intrusive retail price control regulation. Table 3.1 taken from the Commission's 1999 report depicts this relationship.[14]

[14] Productivity Commission at pg 200 of its March 1999 report. "International Benchmarking of Australian Telecommunications Services"

Table 3.1: Retail price controls on PSTN services, February 1998

Country	*Year current price cap began*	*Cap on local services*	*Cap on line rental*	*Local calls*	*Cap on local and long-distance basket*
		(per cent per annum)	*(per cent per annum)*		*(per cent per annum)*
Finland	-	-	-	-	-
Sweden	-	-	CPI	-	-
Canada	1998	CPI–4.5	10	-	-
US	-	a	a	a	-
UK	1997	-	-	-	CPI–4.5[d] CPI[e]
Australia	1996	-	CPI–1	25c	CPI–7.5
France	1997	-	-	-	CPI–9.0
NZ	1989	-	CPI	b	-
Japan (c)	-	na	na	na	Na

na	not available.
-	not applicable.
a	Local service is regulated principally by State authorities with some Federal involvement. Regimes vary State by State.
b	Telecom New Zealand must provide the option of free local calls for residential customers.
c	Japan has direct government regulation of retail prices.
d	Applied to residential services.
e	Applied to a small- business basket.
Note:	Countries are listed in order of increasing PSTN total service price.
Source:	Appendix E.

3.12 Table 3.2, which provides updated data on international price control regulation, shows Australia to have the highest X value of all OECD countries. The weighted average X value across those countries which have retail controls is two. This means price controls are deterring investment in core telecommunications infrastructure.

Table 2.2: International approaches to price controls

Country	*Broad-based Cap on local and long-distance basket*
	(per cent per annum)
Finland	No
Sweden	No
US	No
Germany	CPI - 4
Austria	No
Norway	Ministerial approval
Denmark	CPI –3
Portugal	CPI –2
Netherlands	Approval from regulator for price increases above CPI
Greece	CPI + 3
Korea	No
France	CPI– 4.5
Australia	CPI– 5.5
UK	CPI–4.5
NZ	No
Canada	No
Japan	Approval from regulator
Malaysia	No
Singapore	No

Sources: Communications Outlook and Productivity Commission "International benchmarking" December 1999.

Price controls need to be reformed

3.13 The current price cap is undermining investment, keeping interconnect costs high and inflating long distance prices. Further, it is not meeting any of its equity objectives. It represents very badly targeted assistance. Optus has commissioned research that shows 34 per cent of high-income residential households, including holiday-home owners and intensive mobile users, benefit from the subsidy to basic access in the current cap at the expense of low-income earners, small business, and rural Australia.

3.14 The solution to these problems is for the Government to adopt a cap of CPI – 0 on the aggregate of fixed telephony communications products (basic access, local calling and long-distance service).

3.15 The following benefits would result from such price cap reform:

(a) Long distance prices would fall by over 30 per cent (which would assist people in rural and remote areas who make a proportionally high number of long distance calls);

(b) GDP would increase by $500 million per annum with an additional 3500 jobs being created; and

(c) Carriers would invest more intensively in broadband infrastructure.

3.16 As the company that has constructed the largest broadband residential network in Australia, other than Telstra's, Optus is well placed to judge the detrimental impact of the retail cap on the rollout of alternative broadband infrastructure to Australians. Our HFC network now serves 500,000 customers with telephony, internet and pay-TV services. Optus would have an incentive to considerably increase the roll-out and sign up of consumers on to the broadband network if the retail price cap was reformed.

3.17 In summary the problems with the current retail price controls are that they:

(a) Inhibit investment as they hold core infrastructure over $1 billion below cost;

(b) Prevent Ramsey-efficient pricing as the price cap's sub-constraints prevent recovery of common costs from services with low elasticities;

(c) Motivate costless predation by the incumbent in response to entry; and

(d) Drive the price of services below cost because of the high X value.

Access prices should not be legislated

3.18 In the absence of retail price control reform, legislating pricing principles would remove much needed regulatory discretion from the ACCC, and could result in inappropriate pricing principles being applied. For example, given that line rental revenues are currently held below the cost of access lines, the application of TSLRIC is confused by the calculation of access deficit contributions. The ACCC requires a degree of discretion in the application of pricing principles, incorporating second best considerations, because of the range of distortions that social policies such as price controls introduce.

3.19 Another reason regulatory discretion is needed is because the scope of declaration is currently inappropriately broad. Given that non-dominant networks are currently declared, the application of TSLRIC would clearly be inappropriate. Another example is the declaration of mobile networks. The ACCC chose not to apply a cost based methodology because of the competitive nature of the mobile industry. If cost based pricing principles were legislated and rigidly enforced, this would lead to a reduction in consumer welfare.

Unfettered market processes are better at determining socially efficient prices in competitive markets such as mobiles.

3.20 As argued above, however, if the Commission were successful in implementing its entire reform package, and price controls were reformed and declaration was limited to services provided by a carrier with significant market power – such as services provided over Telstra's local loop—then a legislated set of pricing principles may be appropriate.

Access prices have not been set too low

3.21 In its discussion of access prices, the Commission examines whether the price of access to Telstra's PSTN has been set too low. The Commission notes that the majority of industry believes access prices are still too high, but concludes that access prices may be too low, based on:

(a) ACCC international benchmarking; and

(b) Preliminary views on the application of the TSLRIC costing model.

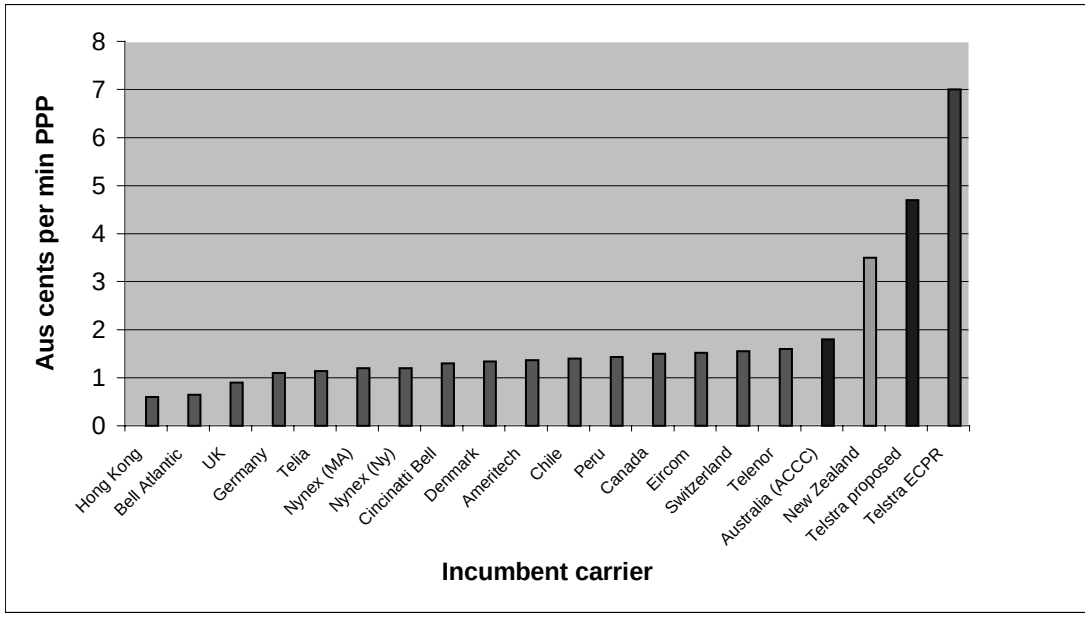
3.22 Optus does not believe that the international benchmarking or TSLRIC data supports the proposition that access prices may have been set too low. In addition to this, the most recent USO revenue data shows that Telstra's revenues have not been remotely impacted by regulated access prices.

International benchmarking shows access prices are too high, not too low

3.23 International benchmarking depends on the data selected. The ACCC's analysis was undertaken to demonstrate that they had done a "good job" in regulating Telstra, and can be expected to draw on evidence to support this contention.

3.24 As Optus has previously submitted, other international benchmarking studies show that Telstra's interconnection charges remain high by international standards. Chart 3.1 shows that interconnection charges are not "too low".

Chart 3.1: Fixed Line Call Termination Gross Charges May 2000



Source: Ovum Interconnection Report May 2000, Telstra Undertaking Submission

The application of TSLRIC did not underestimate costs

3.25 The Commission also suspects that the application of TSLRIC may have led to an under-estimation of costs, and therefore low access prices. The TSLRIC costing process was undertaken over a two-year period, and involved detailed debate around several costing parameters. On each of these parameters, there are a range of views, which if adopted could increase or decrease the TSLRIC estimate. For every parameter that Telstra would like to see revised upwards, there is a parameter that Optus believes has been left inappropriately high.

3.26 There are a plethora of costing parameters where the ACCC conservatively erred on the high-side in terms of access pricing: These include:

(a) The use of scorched node rather than the economically correct greenfield approach meant that the ACCC constructed a Telstra centric network rather than a best in use network;

(b) Not costing the cheaper aerial network structure, even though 17 per cent of Telstra's network is aerial. Best in use forward looking practice suggests this is often the most efficient configuration for the distribution network;

(c) The ACCC used a copper pairs per SIO ratio of 1.3. The actual utilization of pairs per SIO in the Telstra network is 1.1. This 1.1 input parameter reflects Telstra's actual costs.

(d) Distribution network sharing was not forward looking. The ACCC costed Telstra's historical non-sharing practice, with minor adjustment, notwithstanding this practice is not best in use. Best in use practice suggests sharing with 3 or 4 other utilities, including gas, electricity, water and one or two cable companies.

(e) The ACCC did not subtract the $150 million Government subsidy for providing local calling services in remote USO areas from the capital cost base in the NERA model. This was because the Government had not awarded this tender to Telstra at this time.

(f) The NERA model provides too much spare capacity in the inter-exchange network by adjusting busy hour capacity according to average call hold times across the 24 hour period, rather than the shorter average call hold times during the busy hour.[15]

(g) The gamma parameter in the cost of capital did not take account of the Ralph reforms on imputation credit redemption, and incorrectly assumed Telstra was subject to 50 per cent double taxation on profits; and

(h) The cost of certain equipment used by the ACCC was 50 per cent too high, and operations and maintenance expenditure was generally 100 per cent or more too high. For example, the ACCC assumed 50 annual person hours are required for Sydney/Melbourne cable restoration, whereas Optus only requires 16 annual person hours for this cable.

USO data shows Telstra's incentives to invest not impacted at all

3.27 USO eligible revenue data shows Telstra has not lost any share of the value add (revenues) on its fixed network after three years of the access regime up to July 2000. Table 2.3 shows Telstra's share of the total fixed revenue earned on its network over the three financial years up to July 2000.

Table 2.3: Telstra's percentage share of the revenues earned on its fixed network

1997–98	1998–99	1999–2000
91.75	90.18	90.03

Source: Australian Communications Authority, Universal Service Assessment, 1997–98, 1998–99 and 1999–2000

3.28 In other words, after three years of open competition and the access regime, the total share of dollars earned from competitors renting Telstra's fixed local loop to supply long-distance, international calling and the resale of local services has

[15] This means the NERA model provides too much network capacity for local calls during the busy hour, by basing the capacity on the longer local call hold times across the 24 hour period, rather than the shorter local call hold times during the network busy hour.

changed from 9 per cent to 10 per cent. Telstra's share of this revenue pool has changed from 91 per cent to 90 per cent.

3.29 If the access regime had any appreciable affect on Telstra's investment incentives then the data would show a significant change in the relative dollars proportions earned by competitors renting Telstra's local loop, compared to Telstra's own revenue share on its network. [16] This has not happened. In addition, Telstra is at present pricing its services in accordance with the requirements of current retail price control constraints. Optus concludes from these facts that:

(a) Telstra has maintained the same percentage share of revenues earned from its fixed network through time. Therefore, the practical implementation of the access regime by the ACCC has not affected Telstra's incentives to invest in core infrastructure.

(b) Retail price controls are the key barrier to entry and to investing in core telecommunications infrastructure services.

Access prices should not be set "on the high side"

3.30 There is no economic theory supporting the proposition that access prices should be set on the high side in an effort to ensure the incumbent's investment in the local loop is protected at all costs. The economic welfare loss from setting "too high" or "too low" access prices is symmetric around the mean of the correct access price.[17] Setting access prices too high encourages the wrong types of investment, inefficiently limit downstream competition, and create uneconomic price squeezes when operating in conjunction with retail price controls.

3.31 Access prices do not merely affect the investment incentives of the incumbent. They also impact on investment in competitive downstream services. Erring on the "high side" risks holding back competitive investment in downstream services, to the detriment of consumers.

[16] In particular, if the ACCC has set "too low" access prices for renting Telstra's network for long-distance access, then the empirical data would show a significant decrease in Telstra's percentage revenue share earned in supplying telephony on its fixed network through time for several reasons:

- the proportionate dollar value of retailing, intercapital transmission etc would increase relative to the "below cost" terminating and originating access;
- competitors would more rapidly enter and acquire market share in the downstream market with below cost access pricing (thereby capturing a higher total share of this "proportionally inflated" downstream revenue base).

In addition, the rollout of competitor networks would have slowed over the period. The opposite has happened. CWO's local telephony directly connected services in operation have increased from 50,000 to over 350,000 during this period, and we now have over 500,000 customers connected to our HFC broadband network. Hence, none of the expected phenomena consistent with "below cost" access pricing are observed in the empirical data, meaning the thesis is disproved by this data.

[17] See, For example, the Affidavit of William Baumol, Robert Willig and J Ordover to the FCC, April 1996.

Non-dominant operators do not hold market power

3.32 Optus does not agree with the Commission's assessment that in some instances, non-dominant networks can possess market power.

3.33 If a new entrant attempts to raise its interconnection charges above competitive levels it will do so at its own competitive peril. The increase in such charges will be reflected in higher retail charges for calling to, and potentially from[18], the new entrant network. Hence subscribers to the new entrant network will receive fewer calls, and people considering contacting the new entrant network will be deterred by the higher retail prices. In short, competitive disciplines at both the A party and B party end of the call will constrain new entrant networks to set interconnection charges at economically efficient levels. New entrant networks do not have market power.

3.34 This analysis assumes there are no price controls. In a world with price controls, of course, even if new entrants did have market power, price controls would prevent them exercising it.

Benchmarking may be appropriate once a TSLRIC study has been completed

3.35 The Commission argued that once a TSLRIC study has been completed, benchmarking or CPI–X studies may be an appropriate way to set access prices.

3.36 Optus agrees that this may be a useful option to pursue.

Public disclosure by the ACCC could be improved

3.37 The Commission has stated that public disclosure by the ACCC is inadequate, and could be improved:

> *"Public disclosure by the ACCC of methodologies and its justification has not always been adequate and should be improved. Expert groups, international cooperation, peer review and other methods might help resolve enduring disputes over the details of costing methodologies." (p 10.1)*

3.38 Optus agrees that public disclosure of the ACCC's methodologies could be improved, and would support any mechanisms that would assist access seekers in particular to better understand cost models such as the NERA model.

3.39 However, the main barrier to fuller disclosure of ACCC methodology is not really the ACCC, but Telstra. In every costing study in which Optus has been involved, Telstra has obfuscated, claimed that every imaginable piece of data is commercial in confidence, and produced alternative models with no explanation of methodology etc. Telstra has done everything within its power to game the

[18] Where interconnection charges are negotiated reciprocally amongst carriers, the new entrant will incur a higher cost base for terminating calls on the incumbent's network.

regulatory system and hamper the public disclosure of cost models and information. For example, Telstra tried to stop Optus from contesting Telstra's PSTN appeal to the Australian Competition Tribunal. Failing this, Telstra then attempted to stop Optus from viewing Telstra's data disclosed to the Tribunal.

3.40 Even if the ACCC could completely reveal its costing methodologies, much debate centres around the values of the data fed into the cost model, not necessarily the model itself. Again, Telstra has proven itself a resolute opponent of the free flow of information.

3.41 Telstra is also able to use its superior knowledge of its network to derail costing studies wherever possible. Telstra's insistence that its actual PSTN network should be modelled – rather than a fully optimized, forward-looking network skewed the TSLRIC study in Telstra's favor. Access seekers were put in the difficult position of arguing about the cost of Telstra's network, rather than the cost of an efficiently configured network.

3.42 In convening expert groups, and other such fora, care must be taken to ensure that Telstra's superior resources are not used to skew the result of the review. On balance, Optus believes that decisions on these contentious matters must be taken by the ACCC at the end of the day. Whether the ACCC engages consultants, or convenes expert groups is a side issue.

4. Pay-TV programming

Introduction

4.1 This chapter addresses the Commission's views on pay-TV programming, as outlined in Chapter 16 of its draft report. The chapter provides a summary of the Commission's draft position before outlining Optus' views on pay-TV programming. In particular:

(a) The problems caused by program exclusivity are listed;

(b) The importance of pay-TV to investment in broadband networks is discussed;

(c) We analyse the superior competitive dynamic occurring internationally in communications markets;

(d) The international approach used to achieve this sustainable competitive dynamic is outlined, including:

i) Line of business restrictions on incumbent phone companies entering cable pay television; and

ii) Prohibitions on pay-TV operators' use of exclusive program arrangements.

4.2 Finally, this chapter argues against the Commission's proposal to monitor the situation and calls for the Commission to recommend US type open programming arrangements in preference to an extension of the Part XIC access regime.

Commission draft position on Pay-TV programming

4.3 The Commission's chapter on pay-TV programming notes that participants argue that control of pay-TV content through vertical integration or exclusive contracts is being used to leverage market power in the pay-TV market and to limit competition in some telecommunications markets.

4.4 The Commission acknowledges that any inability to acquire sufficient content could delay or eliminate prospects for high bandwidth telecommunications services in regional Australia. However, the Commission concludes that evidence available to it is inconclusive, and so the extent of this problem is unclear.

4.5 The Commission makes the following points:

(a) There may be secondary effects in the current pay-TV market generally and in very high bandwidth services in the future.

(b) To the extent that there is a case for intervention to stem foreclosure of pay-TV content:

i) Part IV of the TPA would probably not suffice as an instrument to tackle this issue, although not necessarily for the reasons given by the ACCC; and

ii) The ACCC's proposal to remedy the problem would not be appropriate as it is currently structured, but with some modifications would provide more open access to content by pay-TV operators, including those in regional Australia.

(c) Other options include:

i) Expanding the coverage of the telecommunications specific access regime under Part XIC of the TPA; or

ii) Maintaining a watching brief on developments in the industry, while signaling a clear intent to legislate if there is evidence that exclusive contracts over pay-TV content are being used in anti-competitive manner in either the pay-TV or a telecommunications market.

Exclusive programming lessens competition

4.6 Optus believes that pay-TV exclusive programming arrangements are being used by Foxtel to lessen competition in subscription TV and related markets. This is causing welfare losses that can be ameliorated through Government action to limit the use of exclusive programming arrangements to those instances where it can be shown to be in the public interest.

Welfare inferior outcomes caused by exclusive programming

4.7 Pay-TV programming is non-rivalrous in consumption. Therefore exclusive programming contracts that frustrate the wider distribution of this content to the community are likely to be against the public interest for the following reasons:

(a) Allocative efficiency is reduced because the distribution of content where marginal benefit (willingness to pay) exceeds marginal cost is prevented.

(b) Consumers are required to subscribe to a particular broadband delivery system (Foxtel's) to obtain access to key programming; this denies consumers competitive choice over communications delivery systems and the wider benefits arising from facilities based competition.

(c) Investment is lowered below economically efficient levels because the productivity of broadband infrastructure is artificially lowered — the prospective investor cannot obtain access to key pay-TV programming.

The importance of Pay TV programming

4.8 Cable networks offer the potential to competitively liberate the supply of broadband communications products that are presently dominated by Telstra. Pay-TV programming is a key driver of investment in broadband communication networks such as HFC cable. This is because net revenues earned from supplying pay-TV programming are necessary to fund the fixed costs of broadband network construction.

4.9 Foxtel is the dominant pay-TV provider in Australia and has entered into exclusive programming arrangements with pay-TV content providers. Under these arrangements, other delivery systems are prohibited from carrying such content. Such anti-competitive arrangements are not observed in countries such as the US and UK. .Governments in both the US and UK have banned dominant pay-TV operators from adopting such exclusive programming arrangements.

Superior form of competition internationally

4.10 Following this micro-economic reform in the UK and US referred to above, the competitive dynamic in these other countries has moved on to:

(a) The digitization of broadband systems;

(b) Investment in interactive television; and

(c) Roll-out of high-speed internet access.

4.11 These countries now enjoy a welfare superior equilibrium relative to Australia, with a high level of facilities based investment, innovation and competition.

4.12 In contrast, investment levels in core infrastructure in Australia and the take-up of new economy services are at critically low levels. For example, competitive cable networks pass 95 per cent of US households, with 66 per cent penetration of cable TV. Over 10 per cent of US homes currently subscribe to high speed internet access. In the UK cable networks pass 52 per cent of homes. Take-up of competitive telephony, digital TV and other broadband products averages 36 per cent, and is as high as 60 per cent in some areas passed by cable. In Australia, cable networks currently pass less than 40 per cent of homes, the take-up of broadband internet access is less than 1 per cent, and the take-up of pay-TV services is less than 20 per cent. The low take-up of pay-TV services in Australia relative to the UK is partly explainable by the exclusivity practices of Foxtel.

4.13 In the US and Europe networks compete over product innovation, packaging, pricing and bundling. The delivery systems do not compete over access to key programming (and denying consumers such programming through exclusivity)

because it is taken as given that all delivery systems will have access to this key programming. The following table shows the innovation in terms of digitization of cable networks in Europe relative to Australia:

Table 4.1: Australia is falling behind

Country	Percent of cable connections upgraded for digital transmission
Italy	100
United Kingdom	50.2
Germany	88.0
France	87.3
Spain	28.0
Austria	20.0
Sweden	42.3
Australia	0

4.14 The competitive dynamic created by independent cable companies competing with incumbent phone companies in new economy services, such as high-speed internet and data access, means Europe and the US are leaving Australia behind in the take-up of high technology communications services. The independent networks are spurning innovation (interactive television), offering new services (high-speed internet access), and investment (digitisation of cable networks). In contrast, Australia is falling behind, with a competitive dynamic focused on anti-competitive practices (program exclusivity) which:

(a) Eliminate competition;

(b) Reduce output and investment; and

(c) Lower consumer welfare.

4.15 Exclusivity has harmed consumers because they have been required to subscribe to multiple broadband systems to obtain access to the full range of high-quality content. In the digital age, exclusive pay-TV programming may significantly increase the loss of consumer welfare.

International approach and benefits for Australia

4.16 The superior competitive dynamic enjoyed overseas did not eventuate through pure laissez-faire economic policy in communications markets. Such a policy failed in New Zealand, and held back communications investment[19] in that country for the last ten years.

Line of business restrictions on telephone incumbents

4.17 Other countries achieved a competitive infrastructure market, in part, by placing line of business restrictions on telephony monopolists, to prevent them over-building new entrant cable TV networks prior to their roll-out. For example, the 1984 Cable Act in the United States prohibited local telephone monopolists from supplying pay-TV programming to consumers. These restrictions were only lifted by the 1996 Telecommunications Act once the new entrant cable network rollouts were largely complete and passed over 95 per cent of US homes.

4.18 Similarly, in the United Kingdom, British Telecom was subject to a line of business restriction from 1991 to 2001. This prevented them supplying pay-TV services to consumers via cable networks. Without such restrictions, prior to the roll-out of new entrant cable networks, the incumbent telephone company could, as has occurred in Australia, roll-out a duplicate cable network on top of the new entrant's infrastructure, and undermine the new entrant's business case. In addition, as occurred in Australia, the incumbent telephone company can cross-subsidize its entry-deterring investments in cable from its monopoly telephony revenues.

Non-discriminatory open program supply

4.19 Governments in both the United States and the United Kingdom have prevented dominant pay-TV operators from entering exclusive programming arrangements. The US 1992 Cable Act prevented:

(a) Discrimination in the supply of programming to competing broadband systems; and

(b) Dominant operators entering exclusive programming arrangements unless they could prove such arrangements were in the public interest.

4.20 In the United Kingdom, BskyB, through OFTA intervention, was required to on-sell premium programming to competing cable companies on non-discriminatory terms. BskyB was required by government to keep detailed regulatory accounts demonstrating this non-discrimination of supply.

[19] Competing cable systems pass approximately 40 per cent of Australian homes whereas presently there is no such comparable investment in New Zealand. Telecommunications is a key productive input for businesses.

4.21 Such pro-competitive micro-economic reform in these countries has led to an expansion of:

(a) Investment in broadband networks, especially in new technologies such as digital delivery, high speed internet access, and the roll-out of interactive television services;

(b) Competition and innovation; and

(c) Consumer choice and demand for pay-TV services.

4.22 Such government micro-economic reform has also produced spillover increases in competition in telephony, internet and other broadband services by communication companies in these countries. Such investments are important in harnessing the full benefits of the information society.

Commission Recommendation

4.23 The pay-TV programming market in Australia has failed. The welfare inferior equilibrium, where 'competition' is characterized by the locking-up of key programming in anti-competitive arrangements, is unlikely to be unwound by market forces.

4.24 The Commission should make recommendations consistent with the removal of market failure and the liberation of competitive market forces. Hence it should recommend Governments enact an open programming regime for key pay-TV content. The United States model is a good example of the superior type of economic reform undertaken in this area; it provides a good benchmark for the type of reform the Commission should recommend.

Monitoring will achieve nothing

4.25 The Commission's draft report suggests monitoring the situation, with the threat of legislation, as an option. Monitoring is a recipe for delay, inaction and stagnation in the current inferior equilibrium. Monitoring will reinforce the continuation of the current market failure and loss of economic welfare.

US model is preferable to extension of Part XIC

4.26 The Commission's draft report also suggests the Part XIC access regime could be extended to potentially include key pay-TV programming. Whilst preferable to monitoring, such a solution is not as economically robust as the US model. Under that model, the onus of proof is placed on those companies with market-power seeking exclusivity over non-rivalrous content to adduce evidence of why such arrangements support the public interest. This is an economically efficient allocation of the burden of proof because it places the onus on those companies in the best position to elicit evidence on why the particular exclusivity arrangements support the public interest (or otherwise).

4.27 Extending the Part XIC access regime to include pay-TV programming is less preferable to the US model for the following reasons:

(a) The Part XIC declaration process will be subject to considerable delay in resolving the current problems caused by exclusivity; and

(b) The US model more efficiently allocates the burden of proof concerning the welfare efficacy of the exclusive programming arrangements.

5. Optus response to other Commission suggestions

Duration of Declarations

5.1 The Commission has recommended that, in addition to the existing revocation mechanism under s.152AO, Part XIC of the Trade Practices Act should include an explicit provision for sunsetting declarations, with a reasonable sunset period to be set at the time of declaration.

5.2 Optus supports the concept of a sunset period where, at the end of that sunset period, the Commission must automatically conduct a review of that declaration to determine whether removal of the declaration is warranted.

5.3 However, Optus does not support the automatic removal of declarations at the end of the sunset period, for the following reasons:

(a) Such an approach is open to gaming by the access provider who may delay or frustrate the provision of access until the end of the sunset period;

(b) The current arbitration process is extremely slow and there is a risk that the sunset period may expire prior to the finalisation of outstanding arbitrations; and

(c) In most cases, the removal of declarations should be accompanied with a review of the effectiveness of the declaration and an assessment of the competitive benefits that have resulted from that declaration. The review process would enable the regulator to assess the effectiveness of its regulation and thus provide the regulator with valuable lessons it could use when declaring other services. Automatic expiry of declarations may mean that regulators fail to carry out this useful process and may make repeated mistakes with subsequent declarations.

5.4 As such, the Commission should amend its recommendation to include a requirement that a review be carried out by the ACCC at the end of a sunset period to assess whether removal of the declaration is warranted.

The role of co-regulation — the Telecommunications Access Forum (TAF)

5.5 The Commission has indicated that it is inclined to recommend the abolition of the TAF but invites comments on the possible future value of the TAF.

5.6 Optus supports the abolition of the TAF given that, to date, it has merely been used by the incumbent as a venue to delay the provision of access. Optus agrees with the Commission that such a body is better suited to parties with common interests and more equal bargaining power. This is never the case when determining access terms and conditions.

5.7 The Commission recommends that the functions currently performed by the TAF should be subsumed within the functions of the ACCC. Optus strongly opposes any TAF functions being taken up by ACIF. ACIF is a body better suited to dealing with technical issues. Optus believes that the issues themselves and the need for a unanimous vote have both led to the failure of the TAF as a body. This would not change if these functions were given to ACIF.

Access seeker and providers

5.8 The Commission has recommended that s.152CPA(3) of Pt XIC of the Trade Practices Act — which prevents the ACCC from making an interim determination if an access seeker objects to it — be repealed. Optus supports this recommendation.

5.9 The Commission has also recommended that s.152CN(1) of Part XIC of the Trade Practices Act be modified to allow notifications by an access provider or seeker to be withdrawn only with the joint consent of the access provider and seeker.

5.10 Optus supports this recommendation, as the current provision is open to gaming. Telstra has successfully gamed the system by withdrawing arbitrations notified by access providers in relation to internet interconnection.

5.11 In general, where both parties cannot agree to withdraw an arbitration, a dispute still exists. It still needs to be dealt with by the ACCC. On the other hand, where both parties agree to withdraw an arbitration, the disputed issues have most likely been resolved by the parties outside the arbitration and there is no need for any further involvement by the ACCC.

The right processes — effective use of regulatory resources

5.12 The Commission has recommended that there should be the capacity for a group of access seekers to lodge a joint notification of dispute and proceed to class arbitration rather than a series of bilateral negotiations.

5.13 Optus supports this recommendation as, in most instances, arbitrations on any given declared service will involve the same disputed issues. This is especially true where Telstra is the access provider — Telstra generally seeks to impose the same access terms and conditions on all access seekers, regardless of the size of the access seeker.

5.14 Class arbitrations will enable the Commission to better utilise its resources and will enable a faster arbitration process when duplication arising from the current system of separate arbitrations is removed.

5.15 The Commission has also recommended that the ACCC should exercise its discretion in allowing the arbitrator to use and disseminate to contesting parties in an arbitration relevant material submitted in other telecommunications access arbitrations, subject to commercial sensitivity considerations.

5.16 Optus supports this recommendation and believes that a more open process will encourage a speedy resolution of the dispute. The access provider and seekers have more timely access to relevant information. In the case of multiple access arbitrations, access to relevant information is vital to ensure a speedy outcome.

5.17 However, the need to consider the commercial sensitivity of the information may allow the owner of that information to unnecessarily delay the arbitration by claiming that the documents are too commercially sensitive to be given to the other party. Confidentiality undertakings can be used to protect the sensitivity of the documents.

Carrier Licence Conditions

5.18 The Commission recommends the following in relation to carrier licence conditions:

(a) Repeal of the legislative requirement for Industry Development Plans; and

(b) Aligning of the various procedures and obligations under the mandatory network information requirement in Part 4 of Schedule 1 of the Telecommunications Act.

5.19 Optus supports the repeal of the requirement to produce IDPs because they:

(a) have been ineffective as there is no sanction for non-compliance and no required level of industry development;

(b) are an unnecessary cost burden on the telecommunications industry; and

(c) there are good cost and efficiency reasons why carriers will continue to make substantial purchases in Australia.

Network Information

5.20 In the draft report, the Commission acknowledges that, where network information is essential for the provision of services, the requirement for mandatory network information would appear to be better placed under the standard access obligations under Part XIC. However, the Commission's draft recommendation merely recommends that the current Part 4 obligations be aligned.

5.21 Optus believes that the Commission's analysis supports the making of a final recommendation that the current network information requirements in Part 4 of the Telecommunications Act be consolidated into the record keeping rules in Part XIB of the Trade Practices Act.

5.22 This will avoid duplication of information disclosure requirements. It will also link requirements for disclosure of network information to the enforcement of

the Standard Access Obligations under Part XIC, and provide a clearer policy rational and focus for the requirements to disclose information.

Number Portability and preselection

5.23 The Commission sought feedback on the following issues:

(a) The desirability of implementing a system of transferable ownership of telephone numbers;

(b) The desirability of determinations made under s.462(2) of the Telecommunications Act being subject to merits review;

(c) The desirability of giving the ACCC responsibility for determining which services, if any, should be subject to preselection;

(d) The benefits and costs of requiring multi-basket preselection; and

(e) The implications of restricting preselection requirements to Telstra alone.

Number Portability

Transferable Ownership of Telephone Numbers

5.24 The Commission puts forward the option of allowing the transferable ownership of telephone numbers, as discussed by Gans, King and Woodbridge (2000).

5.25 By putting forward this option, the Commission is reopening the significant issue of number portability, which has already been mandated by regulators and implemented by carriers for local, freephone, local rate numbers. Significant progress and investment has also been made to provide mobile number portability, which has been mandated for 25 September 2001.

5.26 Provision of number portability involves carriers incurring substantial fixed costs of changing back-office, switching and IT systems. However, Optus believes that sufficient consumer benefit flows from number portability to justify the cost. Once the systems changes have been made, the actual cost of switching the customer is minimal.

5.27 Once a carrier has implemented the appropriate system changes, there is no incentive or reason for the carrier to "buy back" the customer's number to avoid having to port the number. Optus is unable to identify any real benefits that would flow from introducing the option of "buying back" numbers from customers at this late stage. As such, Optus is opposed to the concept of transferable ownership of numbers as espoused by Gans et al.

Review of s.462(2) determinations

5.28 The Commission is proposing opening up for review determinations made by the ACCC under section 462(2) of the Telecommunications Act.

5.29 As discussed above, carriers have already implemented number portability for local, freephone and local rate numbers and have incurred substantial costs and undertaken considerable work in order to deliver mobile number portability in September 2001. Given the nature of these investments, Optus believes that no benefit would flow from reviewing the determinations made by the ACCC under section 462(2) of the Telecommunications Act. The Commission should first consider the costs of reopening this long-settled issue before putting forward the recommendation that section 462(2) determinations be opened up to review.

Pre-selection

ACCC determining the services subject to pre-selection

5.30 Optus supports the idea of shifting responsibility for setting pre-selection requirements from the ACA to the ACCC.

5.31 The provision of preselection is relevant to other work undertaken by the ACCC. For example, the ACCC is currently reviewing the local carriage services declaration. In particular, the ACCC is considering whether the inclusion of local calls into the Preselection Determination would remove the need for the local carriage services declaration.

5.32 Given the interaction of these issues, the ACCC would benefit from a greater understanding of the preselection requirements that would flow from the ACCC having responsibility for determining what services are preselectable.

Multi-basket pre-selection

5.33 Optus is strongly opposed to multi-basket pre-selection for the following reasons:

(a) There are no pro-competitive benefits associated with multi-basket pre-selection;

(b) Multi-basket pre-selection substitute goods currently exist (e.g. call override) and there is no barrier to consumers taking advantage of these products now;

(c) Consumer demand does not exist for multi-basket pre-selection;

(d) Optus believes that multi-basket pre-selection is not technically feasible due to the need for extensive switch development;

(e) The costs of providing multi-basket pre-selection would be large. The consumer benefits which would result are minimal.

5.34 As such, the Commission should recommend that carriers not be required to provide multi-basket pre-selection.

Asymmetric application of pre-selection requirements

5.35 Optus believes that the requirement to provide pre-selection should be linked to market power and should not apply to new entrants for the following reasons:

(a) Requiring preselection where there is no market power reduces facilities-based investment and competition;

(b) Symmetrical preselection requirements are not required unless the new entrant has market power and can control price or supply (which is unlikely to be the case);

(c) Symmetrical application of preselection obligations has been rejected by overseas regulators in the EU, UK and the US, who have consistently refused to apply access and interconnection regulation symmetrically between incumbents and new entrants.

5.36 The Commission should recommend that the preselection requirements be modified so as to apply only where a carrier has substantial market power in a fixed network.

Attachment 1: Optus v Telstra – trade practices proceedings – chronology

September 1994	Optus announced the formation of the Optus Vision joint venture and its plans to compete with Telstra in the supply of local telephone services using the Optus Vision broadband network.
November 1994	Telstra and News enter into the Foxtel arrangements.
10 September 1997	***Optus commences proceedings against Telstra alleging three contraventions of section 46 of the Trade Practices Act 1974, namely:*** ***i) a refusal by Telstra to supply local call access services or local call resale services to Optus either at all, or on reasonable terms and conditions (****the local call resale claim****);*** ***ii) a refusal by Telstra to implement local number portability either at all or on reasonable terms and conditions (****the local number portability claim****);*** ***iii) that Telstra's conduct in constructing its broadband network almost exclusively in areas in which Optus Vision had installed its broadband network, and in using its monopoly rents earned from its local call services to cross-subsidise Foxtel's access to the Telstra broadband network (****the broadband claim****).***
January 1998	Optus gives discovery of approximately 7000 documents.
Early 1998 to mid-1999	Telstra seeks ongoing particularisation and clarification of the allegations in Optus' statement of claim.
November 1998	Optus gives discovery of approximately 2500 further documents.
May 1999	Optus gives discovery of approximately 2000 further documents.
May 1999	The parties mediate the local call resale claim and the local number portability claim.
July 1999	The parties settle the local call resale claim and the local number portability claim.

August 1999	Optus gives discovery of approximately 2500 further documents.
October 1999	Optus gives discovery of approximately 2000 further documents.
November 1999	The parties mediate the broadband claim.
December 1999	Optus gives discovery of approximately 1000 further documents.
July 2000	Optus files and serves its lay and expert evidence – 18 statements comprising 436 pages of text plus many hundreds of exhibits.
Mid to late 2000 onwards	Optus continues to give substantial discovery so that by May 2001 approximately 25,000 to 30,000 have been provided to Telstra.
14 February 2001	Hearing fixed to commence on 3 September 2001 with an 8 week hearing time estimate.
14 February 2001	The Court makes orders requiring Telstra to file and serve all lay and expert statement of evidence on which it proposes to rely at the hearing on or before 30 March 2001. Telstra indicates that it will have approximately 40 witness statements.
30 March 2001	Telstra serves four statements of lay evidence.
April 2001	Telstra serves two further statements of lay evidence.
7 May 2001	Telstra serves six further statements of lay evidence.
8 May 2001	Telstra serves four further statements of lay evidence.
11 May 2001	Directions hearing. This is the 36th directions hearing in the four year life of these proceedings and, despite that, numerous pleading, discovery and evidence issues remain in dispute between the parties.

Attachment 2: Regulatory requirements for local loop unbundling

Country	Regulatory requirements for ULL
Australia	Required and conditions to be specified by October 2000.
Austria	Implemented on July 1999. Raw copper unbundling only — no bit stream access or line sharing.
Belgium	Consultation process under way.
Canada	Implemented in May 1997. Facilities that were classified as essential are subject to mandatory unbundling. Monthly rates for unbundled local loops were approved in November 1998.
Czech Rep.	To be introduced after 2002.
Denmark	Implemented in July 1998.
Finland	Implemented in 1997.
France	Available from 1.01.2001. Includes raw copper unbundling and line sharing.
Germany	Implemented in January 1998.
Greece	Public consultation underway.
Hungary	Obligation for unbundling will be stipulated in the Unified Act on Communications that is expected to enter into force in 2001 or 20002.
Iceland	Came into force on 1 October 2000.
Ireland	Bit stream unbundling available from 2000. Full unbundling on April 2001.
Italy	Expected implementation date Summer 2000.
Japan	Ministerial Ordinance on unbundling came into force in September 2000.
Korea	Not available.
Luxembourg	Unbundling is not required.
Mexico	Not available.
Netherlands	Unbundled access to the local loop available since December 1997. OPTA laid down guidelines indicating the way in which it would settle any disputes over unbundled access in March 1999. Prices under negotiation and regulatory assessment.

Attachment 2: Regulatory requirements for local loop unbundling (cont…)

Country	Regulatory requirements for ULL
New Zealand	Under consideration in context of Ministerial Inquiry on telecommunications.
Norway	Parliament decided in April 2000 to require unbundling. Regulatory provisions are being introduced in the regulatory framework for unbundling.
Poland	The new Telecommunication Law coming into force on 1/1/2001 provides for unbundling.
Portugal	The regulator launched a consultation in 2000 and unbundling was introduced on 1 January 2001 and the incumbent should make a reference ULL offer available by 2 February 2001.
Spain	Unbundling for ADSL bitstream access was commercially available in September 1999 following an Ordinance by the regulator. Regulations are being prepared for full local loop unbundling.
Sweden	The incumbent has since March 2000 offered access to the copper network but at a price higher than the retail line subscription price. The legal possibility of legally requiring unbundling is under consideration.
Switzerland	An ADSL offer on a wholesale basis is available for other telecommunication service providers. There is no explicit legal basis for local loop unbundling but in the context of interconnection regulation a demand can be addressed to the Federal Communications Commission (ComCom) if commercial negotiations fail. Such a demand has been made and ComCom stated in a provisional decision the obligation for the incumbent to offer bitstream access at cost-based prices and to prepare a reference interconnection offer. This provisional decision has not entered into force as the incumbent has appealed to the Federal Court.
Turkey	Not available.
United Kingdom	Came into force in August 2000. Full unbundling available and the regulator can set the price for unbundled local loops.
United States	In 1998, the FCC mandated elements of the local loop to be unbundled.

Source: OECD.