SaskTel International

Commentary on the Productivity Commission's Draft Report prepared for further public consultation and input in respect of its *Review of Telecommunications Specific Competition Regulation*

Submitted by Saskatchewan Telecommunications International, Inc.
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EXECUTIVE SUMMARY

This submission provides general comment in response to the Productivity Commission's draft report on its "Review of Telecommunications Specific Competition Regulation" issued March 28, 2001.

The Productivity Commission has been given a mandate to examine and report on how telecommunications specific regulation can improve the overall economic performance of the Australian economy. In its report, "Productivity Commission 2001, *Telecommunications Competition Regulation*, Draft report, Canberra, March, (herein called the draft report) the Productivity Commission thoroughly canvasses economic theory and resultant policy initiatives that may help to improve overall economic performance of the Australian economy. This submission will not specifically review and debate economic theory or policy initiatives. Rather, this submission will approach the issues from the practical perspective of a company that has made access infrastructure based investments in several developed countries and, in that way, seen the improvement of economic efficiency in those economies.

It is the view of SaskTel International (SI) that competition in local access telecommunications markets unquestionably improves the overall economic performance of an economy. Facilities based competition in broadband customer access network (access networks) services produces the most meaningful and sustainable improvements. This type of competition can be successfully implemented in small economies and small geographic areas within larger economies.

The current *laissez-faire* telecommunications policy in Australia, supported by general competition law, is not working. The general lack of development of access networks in capital cities, as well as regional Australia, since 1997 is evidence of this fact, as are the monopoly level profits Telstra continues to enjoy.

Access network competition in Australia is evolving in a very spotty and disorderly fashion. It should be of concern to Australians that major international carriers have not shown recent interest in building competitive access networks in Australia, a further testimonial to the external view of the regulatory climate. While the lack of investment on the part of major international carriers may not be of concern to some, the reasonable expectation would be that development activity would be undertaken locally. It should be considered unacceptable that large segments of capital cities do not have access to a competitive access network. It should also be considered unacceptable that regional centers do not have access to products supplied by alternative network based service providers. Where regional investment has occurred it has been undertaken by investors with little telecommunications experience. There is a sense that access network ventures are very lucrative and can be undertaken by any group with access to capital. This, as the Australian press reports daily, is not proving to be the case.

The drivers behind the lack of development of a strong alternative competitive access network market can be directly mapped to a weak and unpredictable regulatory environment. SI views the main reasons for the lack of credible access network competition in cities and regional Australia can be broadly categorized as the lack of carrier rights and the inability of new entrants to access product.

LACK OF CARRIER RIGHTS

In most developed countries carrier licenses are relatively difficult to obtain but, once secured, carriers have the ability to access pole and duct infrastructure on predetermined terms and conditions. Carriers also have certain responsibilities relative to any network build that are closely monitored and must be adhered to. This is not the case in Australia. Carrier licenses can be easily obtained but access to infrastructure is essentially left to the discretion of the local power distribution utility and Telstra. A new entrant must have access to aerial infrastructure for the project to be viable, especially in regional Australia where economies of scale and scope are not as great. Leaving the terms and conditions of access to such infrastructure to the discretion of the power utility and the incumbent carrier does not facilitate investment in regional communities.

As well, the ability of local Councils to arbitrarily and individually tax owners of access networks is not conducive to attracting investment in cities or regional communities. Investors in large infrastructure projects that have long paybacks, while quite willing to accept business risk, must have some degree of certainty as to what the rules will be on a long-term basis.

While perhaps not a pressing matter today, SI feels that the lack of carrier rights will have a significant impact on the ability/willingness of carriers to build or expand, as in the case of Optus, their networks in the future.

INABILITY TO ACCESS PRODUCT

SI is of the view that two physical access networks are required for Australians to enjoy and reap the benefits of competition. This form of competition is the means to the end; the improvement of the overall economic performance of the economy will be the by-product of facilities based access competition.

It should be noted that Telstra appears to recognize the benefits of facilities based competition as evidenced by its recent entry into the New Zealand market via the Telstra-Saturn venture. SI was the original telecommunications partner in Saturn and is proposing a network in regional Australia similar to that being rolled out in New Zealand.

For a new entrant, facilities based access competition requires building past 100% of homes and businesses with the expectation that, possibly, 25-35% will become customers over a period of time. Accordingly, realizing economies of scope and scale are critical to its success. For ventures to be viable, especially in regional Australia, they must have access to product, whether it be telecom interconnect or pay television programming, on consistent and reasonable terms. Again, a new player requires reasonable certainty around its product offerings and cost structure before projects of this nature will be undertaken.

While interconnection with Telstra is attainable, unacceptably long lead times are required to negotiate and effect physical interconnection. In addition, Telstra games the system and appeals interconnection pricing determinations which adds significant uncertainty to start-up businesses. Blocking strategies of this nature must be eliminated and replaced with a more reasonable process mandated and overseen by the Regulator.

SI has been unable to access pay television content considered critical to achieving required economies of scope. This is largely due to anti-competitive exclusivity arrangements within vertically integrated carriers. Again, a very effective blocking strategy employed by the incumbent.

Generally, the current regulatory régime has failed to recognize, or at least manage, the power of Telstra, as a dominant carrier. The result is that Telstra has been extremely successful in its ability to effectively curtail competition via, at best, delaying and, at worst, denying access to product, thus significantly impacting the entry of access competitors in Australia.

The regulatory régime in Australia is at a cross-roads. The current system is not working, will not work and, thus, will not achieve the stated goal. Federal government objectives of maximizing the value/dividend stream of its Telstra holding (as seen in recent ministerial pronouncements expressing pleasure at the level of dividend income that Telstra can deliver to the Federal government coffers in the absence of significant revenues from the 3G spectrum auctions) and effecting real and sustainable competition in the Australian telecommunications market are at odds. As a result, Australia trails the field in its ability to universally offer consumers and businesses state of the art products and services at reasonable prices.

Achievements in effecting access competition to date have been marginal in the consumer and small and medium enterprise business segments. Achieving additional and material benefits requires immediate action to provide a more predictable environment for new access network entrants and to attract credible international operators. To this end, SI puts forward the following recommendations:

1. **TO IMPROVE THE OVERALL PERFORMANCE OF THE AUSTRALIAN ECONOMY, TELECOMMUNICATIONS POLICY SHOULD ENCOURAGE FACILITIES BASED COMPETITION IN BROADBAND CUSTOMER ACCESS NETWORKS.** *The Federal government needs to clearly state that it desires to improve the overall economic performance of the Australian economy; and that it plans to do this, in part, by encouraging the development of competitive broadband access network alternatives to Telstra. It should introduce a new regulatory environment that will support that objective.*

2. **A NEW CLASS OF CARRIER - THE FACILITIES BASED CARRIER - SHOULD BE CREATED.** *The current access régime in Part XIC and the anti-competitive conduct and record keeping rules in Part XIB of the Trade Practices Act, 1974 has not, and will not, lead to the development of competitive broadband access network alternatives to Telstra. A new class of facilities based carriers should be created. Facilities based carrier licenses should be accompanied by obligations and powers to build a network. The access régime should be amended to require "any to any" connectivity between these carriers on facilities based carrier to facilities based carrier prices, terms and conditions. Access services provided to a carrier that is not a facility based carrier should be provided at a higher price and on terms and conditions appropriate*

to their function as a reseller. New facilities based carriers should be given a period of time during which they are not required to make access to their networks generally available.

3. **One body of legislation should govern telecommunications.** *In introducing the new environment, the Federal government should implement a consistent regulatory framework across all levels of government including all State and Council bodies. The new facilities based carriers should have the ability to access existing infrastructure on pre-determined terms and conditions that apply to all parties, overriding State and Council legislation where necessary.*

4. **Content should be available to all service providers on equal terms and conditions.** *To increase the level of competition in telecommunications markets, the Federal government must introduce legislation that will make telecommunications infrastructure, pay television content and Internet connectivity readily available to competitors and on terms and conditions that do not favor the dominant incumbent(s).*

5. **An industry specific regulator should be created to supervise the implementation of the government's new policy.** *General competition law cannot by itself promote the development of facilities based competition and the resulting improvement in the Australian economy. The communications industry will require a specific regulator with powers to investigate, make decisions (including interconnect prices, terms and conditions) and to generally take actions to implement the new government policy. The regulator will ensure that no carrier is behaving in an anti-competitive manner. Once the government is satisfied that the Australian economy is experiencing significant benefits from competition in telecommunications markets, it can place the industry under the general competitions legislation.*

DISCUSSION

TO IMPROVE THE OVERALL PERFORMANCE OF THE AUSTRALIAN ECONOMY, TELECOMMUNICATIONS POLICY SHOULD ENCOURAGE FACILITIES BASED COMPETITION IN BROADBAND CUSTOMER ACCESS NETWORKS.

Competition in local access markets improves the overall economic performance of an economy. This improvement flows from the benefits of wider choice and lower prices to business and residential consumers. Facilities based competition in these markets enables the greatest difference between alternate providers in product and pricing. Therefore, facilities based competition should deliver the largest overall direct and indirect benefits and improvement to the Australian economy. SaskTel International is of the view that there are many regions in Australia where the improvements to the economy to be realized from implementing facilities based broadband access competition far outweigh the economic cost. Some of these areas are as large as Perth and Adelaide. Some are as smaller and regional such as the Newcastle region.

The direct and indirect benefits that an economy will enjoy from the development of a competitive broadband customer access network are numerous and substantial. They include:

- increases in the number of downstream services and service providers by increasing the access capacity as well as providing choice in access service providers and technology solutions,
- lower input costs resulting from competition between alternative suppliers and increased choice of technologically diverse access services,
- developing new businesses and activity from the construction of the networks and from the increased capacity (bandwidth and technology) the new networks can deliver,
- increased ability for market participants to participate in Internet activities including e-commerce,
- increased ability for market participants to become full participants in the information economy,
- increased ability for governments, hospitals, schools and universities to improve the services they deliver and, at the same time, lower their costs,
- increased ability for residents to work from home with the attendant favorable social and economic impacts.

It has been suggested that a customer access network is a natural monopoly and that, in a natural monopoly environment, having only one physical network is more efficient economically. SaskTel International agrees that in some geographic environments the costs of constructing an alternative access network would result in an increase in the total industry cost to produce the capacity. The areas that are a natural monopoly are rural and remote but, even then, the monopoly characteristics apply only to wireline based additional capacity. In the broadband access services market, even regional areas can benefit from the presence of alternative access providers. This is especially the case given that the cost for the incumbent to augment their access network to enable broadband capabilities will often rival the cost of building a new alternative access network. In the absence of competition, an unregulated monopoly incumbent has no market encouragement to act in a competitive manner and reduce monopoly profits. The presence of competition encourages them to act in an economically efficient manner in this undertaking.

SI invites the commission to look at the experience of other countries. Facilities based access competition has been successfully introduced in a number of countries and economies which have significant parallels to the Australian geography and economy.

Alternative customer access networks have been built in the United Kingdom and in New Zealand. These new wireline network based service providers have caused significant reductions in retail market prices. They have also pioneered and led the development of new service offerings - far in advance of the incumbents. In North America there are two facilities based customer access networks in most rural, regional and urban areas. Pay television operators use their networks to deliver pay television, high-speed Internet and data services to consumers and businesses. Increasingly pay television operators are exploring the introduction of voice services to be offered in competition to the incumbent telephone companies. The potential for Pay television operators to make significant inroads into the telephone company's core business has caused the incumbent telephone companies to be very attentive and responsive to customer needs in most markets. In the new digital world, customer access networks are not natural monopolies. They are, in fact, the basis for sustainable and active competition. Telstra recognizes this fact and through its "gaming" the regulatory system and through its indirect control of key pay television content is leveraging its network to prevent the development of alternative access networks.

It is noteworthy that Australia is one of the few economies in the developed world that does not have a strong, vibrant and pervasive cable television industry. Other countries have, by design or by accident, employed measures that have enabled the development of alternative broadband access networks. The primary measure that has been employed seems to have been to temporarily favor or encourage the broadband infrastructure developer with favorable access to content distribution rights. Even New Zealand has an effective alternative broadband access provider. This appears to have resulted from the efforts of a knowledgeable and capable new entrant developing its own content and acquiring content distribution rights while the incumbent chose to refrain from making necessary infrastructure investments and entering the pay television distribution business. Australia has chosen not to pursue a policy that would favor the development of an alternative broadband access industry and has suffered the consequence of impeded development of broadband access networks.

As indicated, many other countries have at least two access network service providers; the incumbent telephone company and a cable television company. In areas where this is the case, broadband Internet prices have been reduced dramatically because the two companies must compete for customers. A case in point is Canada, where high-speed Internet services are widely available in urban and regional areas for CAD $40 per month (AUD $50) with no usage charges. In Saskatchewan, SaskTel provides high speed Internet service to communities with as few as 2000 residents. High speed Internet service is available to almost 60% of the population in a region where almost 25% of the homes are located on farms. Compare this to Australia where Telstra is charging AUD $80 per month plus usage and offers the service only in selected areas. In addition, Telstra is proposing a charge of almost the same amount for wholesale access to its copper wires for competitors to install their own equipment and offer high-speed services.

There has been a suggestion that a private enterprise choice to develop alternative access networks may result in the economy acting in an economically inefficient way by increasing the total industry cost of producing telephony access capabilities and thereby increasing costs to the economy. It is SaskTel International's position that, notwithstanding the theoretical economic arguments that can be made to support this view, actual experience, as indicated above, shows that the theoretically possible adverse results have not actually occurred in any economy. In fact there are a number of powerful practical disincentives to theoretical oversupply occurring.

- Building an access network is an expensive and risky undertaking that will be undertaken in response to market demands and only in environments where there is an appropriate balance of risk and return. If the market does not produce a return on the expenditure required to build a competing network, or if the environment unduly favors the incumbent, there will be no competitive entrants. SI's research has shown that there is significant market demand for the services that can be delivered over an alternative access network in regional Australia. SI would view the slow development of facilities based competition in Australia as an example of a difficult regulatory environment.

- Significant shareholder capital is needed to build an alternative access network. While there will be a number of new entrants attempting to get into the business, a successful track record will be necessary to increase the chances of success. Start up capital is likely to be advanced by sophisticated investors with experience in operating like businesses. This type of investor is not likely to be interested in a venture where they do not perceive any economic advantage. The business model they pursue will include new capabilities and new services that are not available over the incumbent's wireline access network. Providing only simple voice access in competition to the incumbent will not justify the cost of building the alternative network. The economy and the new entrant will benefit from the introduction of many new services on the network.

- Investors will bear the risk of business failure. If they do not see others succeeding in the market, or if they do not perceive any chance of market success, they will not enter the market. If they do not enter, there will be no capital for new businesses to start competing with the incumbent. The current lack of competition in Australian broadband access telecommunications markets suggests that investors do not see a significant chance of success. SI would suggest that the major contributing cause to this is the regulatory régime. SI comments later on the tendency of the current regulatory régime to advantage power utilities that have no expertise in building or operating telecommunications networks or in providing telecommunications services and the adverse impact that this is having on the development of competition in Australia.

- Even if there is no advantage to an economy for new entrants to build a competitive broadband customer access network, there is no way for the new entrant to successfully pass higher prices on to a paying customer. The incumbent is not likely to raise prices to compete with the new entrant. Again, the investors bear this market risk.

The cost of business failures is a normal element of economic activity that is factored into the overall costs of a healthy economy. If a regulatory approach that encourages the intelligent development of a competitive broadband access network is adopted, it is submitted that market forces will govern the efficient allocation of capital and the efficient construction of competitive networks.

The broadband access market is not a natural monopoly. There is significant differentiation between access services. Telstra itself offers 3 different types of broadband access. Were the markets a natural monopoly one would expect that the monopoly provider would settle on one service only. The market for access services is rapidly changing. Technological convergence is making once separate and distinct industries, such as pay television and telephony, able to offer services in the others markets. Downstream services and markets are converging as well as products like Internet service develop and become capable of being accessed by more than one access technology. As the technologies develop and more and more services are introduced there is an increasing demand for access services.

It is clear that prices will not come down while Telstra has a monopoly on the customer access network. It is also clear that, if the current policy with respect to competition in local access markets continues, Telstra will extract monopoly profits from the economy and the high pricing policy that Telstra employs will result in fewer consumers, institutions and businesses able to take up high speed Internet service. Downstream service providers and access-based competitors will suffer from limited development. Telstra's actions, while understandable in the context of the current regulatory régime and in the absence of competition, amount to a significant cost to the community in the form of higher prices, lower uptake of services and opportunities lost.

The options appear straight forward; adopt policies that promote the development of competitive broadband access networks and realize the economic benefits or adopt policies that tend to impede the development of competitive access networks and suffer the consequences of:

- decreased opportunities for employment and wealth generation,
- a smaller economy than would otherwise develop,
- less industry, employment and attendant tax revenues,
- decreased attractiveness of Australia as an economic hub for the Asian-Pacific region,
- decreased investment in the economy and, at best,
- delayed and limited development of broadband services.

A NEW CLASS OF CARRIER - THE FACILITIES BASED CARRIER - SHOULD BE CREATED.

The current access régime best supports a “wholesale” or “resale” model under which competitors resell services they create using the incumbent’s infrastructure. While the services offered may theoretically be part of an entirely new service offering, the services actually offered are most often near exact replicas of what the incumbent has in the market. While access to the incumbent’s network is necessary to assist in the development of competition, it will not in itself result in the emergence of strong competitive alternatives. Some of the reasons are as follows:

- Service providers who rely upon the networks of others are dependent on their supplier’s cost structure. Even if there is margin available at the time they enter the business, competitors will ultimately face pressure on their margins as competition results in a market price decline and they find they cannot manage the underlying costs of their business.

- Resellers cannot differentiate their product offering sufficiently to master their own markets because they rely on their supplier’s technology.

- The new entrant cannot develop a customer service ethic that will differentiate their business from the incumbent’s as they rely on their supplier’s customer services, maintenance services and operations and repair services.

- A single customer access network will remain a bottleneck facility. A single access network will not provide sufficient bandwidth to support the vast number of potential downstream services that may be developed in the future. In addition, the technology the single provider employs may limit the types of services that can be developed. Competition in downstream markets will be impeded if downstream service providers have only one source of supply of the access necessary for their products.

Resale based telecommunications competitors will always be weak competitors. Competition policy must acknowledge this business reality. Weak competition in telecommunications markets will not deliver significant improvements in the overall performance of the Australian economy. If the benefits of competition are to be realized, facilities based competition must be recognized and adopted as the only sustainable model.

New networks can be constructed at a similar cost to what is required to upgrade an existing network. They can be constructed in a manner that is more in keeping with the new technology demands of the emerging services. This increase in access capability in a marketplace tends to decrease costs in the incumbents business as well, because competitive forces cause the incumbent to make adjustments to its operations to improve operating efficiencies. Facilities based competition produces the most meaningful and sustainable improvements to an economies productive capability.

A community seeking to benefit from the impact of competition in telecommunications markets cannot count on the "wholesale" or resale model to deliver to the communities needs.

Competitors employing the resale model will typically rely on the incumbent's network to deliver their services. They make their profit by buying in bulk, adding their unique marketing services and passing some of the savings on to their end customers. As their success leads to lower prices in the marketplace their margins diminish to a point where no further price reductions or service development can occur without them causing their own business failure.

In addition, they cannot compete with the incumbent on the basis of service and product differentiation because their products and services rely on the incumbent's network for their underlying technical capabilities. The incumbents legacy systems and processes are very difficult to change. There is no economic incentive to improve them. Monopoly incumbents' greatest return on the investment that their shareholders have made is to continue to offer services using existing processes. Requiring an incumbent to modify its existing systems and processes to accommodate a resale model is expensive to the point of being counter-productive to the policy objective of lower costs. The only way to achieve lower costs is to encourage the development of new systems through the development of new competitors.

Finally, the service levels the competitor is able to deliver are dependent on the service levels the incumbent is able to deliver. The wholesale competitor cannot deliver a unique product or service from a customer service perspective.

Ultimately, this model leads to market equilibrium. The surviving "wholesale" based competitors take a small portion of the incumbent's business. Business and technological realities restrict their ability to vary their products and prices. They are similarly restricted in their ability to differentiate and compete on the basis of customer service. The market settles at a point where there is less competition and attendant economic benefits than if the economy would enjoy if there had been facilities based competition.

Clearly the fact that there may be any number of resale or "wholesale" based competitors in a marketplace is not in itself a sign that sustainable competition will develop to the long term benefit of the community. Facilities based customer access network competitors are needed for a community to experience the benefits of true competition in telecommunications markets. The economy benefits from this investment in additional infrastructure. Competition between infrastructure based competitors will deliver the greatest economic benefit.

Infrastructure based service providers represent a different type of economic agent than resale based service providers. They make an investment in capacity. The increased capacity enables development of downstream markets as well as direct competition with the incumbent and the improved and differentiated services and prices that direct competition delivers to the incumbent, its shareholders and the markets it serves.

Access network infrastructure based businesses are not natural monopolies but they are, by their nature, investments from which shareholders can expect to see a return only in the longer term. A large capital investment is required in the early years. The new competitor must build a network, establish operating systems and acquire customers. The investors must fund operating losses for 3-4 years. Because of the significant up front costs and initial operating losses, these ventures are not typically profitable for at least five years with simple payback of its initial investment in a 10-12 year timeframe. For example, after five years of operations Optus has only recently managed to make its broadband business profitable.

The long-term nature of investment in customer access network based businesses means that they are of interest to investors with an investment horizon not common in today's markets. Shareholders are required to place their start up money at significant risk in order to return a profit in the long term. Once they have started construction of the network they cannot recover their investment except through completion of the construction phase and successfully marketing to the local community.

The risks are significant and the potential returns modest and years out. This is especially true for the second entrant in a the wireline access with its small economies of scale. The new entrant must build past 100% of the marketable homes and businesses in the area where it chooses to compete while hoping to win possibly 25%–35% as customers over several years. Investors interested in short term, quarter by quarter, returns are not likely to decide to make this type of investment. Only experienced operators with a long-term perspective will be interested in developing this market.

It will take approximately one year, from the commencement of the Development Application process, to build a network to the point where the investors can expect to start selling products on it. While the new entrant is establishing its business the incumbent takes actions in the market to stifle competition and enhance their position in the market. Telstra has proved to be a master at this game. It has chosen to take advantage of every opportunity the current regulatory régime afford it. Its strategy is to negotiate, arbitrate, and litigate. New entrants can not even be sure that the terms of interconnection they obtain through the ACCC arbitration process are the terms that they will ultimately obtain because Telstra has chosen to appeal the arbitration awards to the Australian Competition Tribunal.

Telstra recognizes that the only form of true competition it should fear is competition in the customer access network and has chosen to restrict access to key pay television services that a new entrant requires to successfully compete with them. New entrants and their investors face significant competitive obstacles from an able incumbent. The regulatory environment is favorable to the incumbent, and Telstra uses it to maximum advantage.

Potential telecommunications infrastructure investors are well aware of these risks and, as a result, are reluctant to invest in Australia. In fact, SI is not aware of any other similar private businesses looking to invest in businesses that build and operate competitive broadband customer access networks in Australia. Even Optus, the main alternate access provider, stopped its network build in 1997 to concentrate on marketing and sales.

Perhaps the most insidious aspect of the current access régime is the fact that it treats all potential competitors in the same manner. Facilities based competitors are given no advantages over resale based competitors. This is balanced by the fact that they have no obligations either.

The net result is that all carriers are the same. Telstra finds itself in the situation where it must offer "interconnect" prices and terms and conditions to competitors that are in fact its largest retail customers. There is nothing to require the "carriers" to be large buyers or even contributors to the productive capacity of the telecommunications market.

The current regulatory régime respecting resellers should be revisited to ensure that it is consistent with the desire to encourage facilities based competition. There is a significant difference between each regarding the types of benefits and the levels of benefits that they can deliver to an economy. It is submitted that a policy that treats facilities based competition and resale competition in the same manner causes inappropriate investment decisions and deprives the economy of the long term benefits of an alternative access network. At the same time it imposes a burden on the incumbent to be "all things to all resellers" and "all things to all downstream providers". This is a burden that the incumbent cannot and should not bear.

Because building an alternative wireline customer access network provides such clear and obvious benefits to an economy, other jurisdictions have chosen to nurture the development of access based competition. They have done this in a number of ways, including:

- favoring the new entrant with pay television content distribution rights,
- imposing the obligation to build competitive access networks in specific geographic areas,
- granting carriers rights to build networks in the granted area.

The policy approach of creating facilities based carriers with rights and obligations as distinct from other types of carriers has worked to the benefit of the economy in other countries. The Australian policy experience has been to encourage the creation of two facilities based broadband access providers in each of the large cities. That has proved to be a failure for a number of reasons. The failure of that particular policy does not mean that facilities based competition, as a goal is inappropriate. Rather it means that the way the goal was achieved, without any protection for new entrants, was inappropriate.

It is submitted that the policy should be to favor the development of only one competitive facilities based broadband access service provider per geographic area. This facilities based competitor would compete with Telstra for the provision of broadband services but, for a period of time, Telstra should not have the right to build a competitive network or distribute pay television in the new entrant's area.

ONE BODY OF LEGISLATION SHOULD GOVERN TELECOMMUNICATIONS

The Federal government has chosen to make it relatively easy to acquire a telecommunications carrier license, but, by not giving carriers any utility powers, has made it very difficult to build a network. New entrants must obtain planning consent from all Councils in their chosen build area, each of which has its own expectations, regulations, processes and costs. Alternatively, at least in the case of New South Wales, they may have their project deemed to be State significant and obtain planning consent through that avenue. To the extent that any such consent is needed, the current regulatory structure will favor the dominant incumbent that has a network in place.

The time and expense associated with pursuing the Development Application(s) introduces an element of risk into a business case that tends to impede the introduction of competition. It does this by causing new entrants to refrain from starting their construction projects until the Development Application has been approved and its terms and conditions are known. This delay and cost inevitably works to the advantage of the dominant incumbent and will delay the introduction of competition.

Building a new telecommunications network is a very costly undertaking. Access networks can be built using overhead or underground facilities. The fact is that given the much higher costs of building underground it is not economically feasible to build a competitive access network unless it is built using overhead wiring. SI has already noted that becoming a carrier does not give a new entrant carrier's rights. This means that under the current regulatory structure a new entrant must reach commercial terms for access to necessary infrastructure with a power company, as they are the owners of the poles on which a telecommunications network can be economically built. Dealing with the power companies adds extra cost and delay. Some of the not so obvious problems arise out of the power company's legitimate desire to retain influence over who has access to their infrastructure - at least to the extent that direct competitors in their industry are concerned.

In addition, new entrants are faced with the prospect of paying a charge to local Councils for the space that cables occupy and to the power companies for access to their infrastructure. Negotiating fees and charges that these agencies levy also contributes to delaying the introduction of competition. These groups also recognize the construction of new networks as an opportunity to extract a tax. There is also risk that the new entrant will find the commercial arrangements or licensing fees of either the power company or the Councils increasing unilaterally over time. It should not be suprising that no private company has been able to start a competitive alternate access business since the advent of the new regulatory régime. The lack of carriers' rights amounts to a prohibitive disadvantage to new entrants.

The policy path the Federal government chooses to promote competition should not be subject to variation, intentional or otherwise, by State or Council policy or regulation.

CONTENT SHOULD BE AVAILABLE TO ALL SERVICE PROVIDERS ON EQUAL TERMS AND CONDITIONS

To increase the level of competition in telecommunications markets, the Federal government must introduce legislation that will make telecommunications infrastructure, pay television content and Internet connectivity readily available to competitors and on terms and conditions that do not favor the dominant incumbent(s).

SaskTel International's experience suggests that, with an appropriate bundle of services, a new entrant can hope to acquire up to one third of the incumbent's telecommunications business, one half of the high speed Internet accesses and, with acceptable programming content, one half of the pay television market in the area. It takes a new entrant five to seven years to establish this presence. The new entrant must build 100 per cent of the area to acquire these businesses. The network construction costs must be spread over multiple product lines. The interconnection and pay television content costs must not be so high as to eliminate necessary operating margins. Experience has shown that a new entrant requires a minimum of 100,000 to 125,000 homes to support the business model and, even then, the business delivers a return on equity somewhat lower than that currently enjoyed by Telstra shareholders.

Facilities based competition will emerge only if a new entrant is able to develop its network and service offerings at a reasonable cost and to offer multiple services over its network. Economies of scale and scope are necessary for a facilities based new entrant to succeed. The economics of starting a new business require balancing a number of factors:

- There must be a sufficient number of residences and businesses in a compact geographic area to result in a reasonable cost per home or business passed.

- Revenues must be sufficient to recover the costs of building the network, the necessary supporting infrastructure and cover ongoing operating costs as well as providing a reasonable return to shareholders.

All of this suggests that the new entrant must be able to offer more than one service over its network so that it is able to achieve economies of scope on its investment - deriving revenues from more than one line of business.

Ensuring that pay television content is available is critical to support a new entrant. Content provides them with an additional revenue stream from the networks that they will be building. It reduces the amount of customer churn. Ensuring that a dominant vertically integrated incumbent does not monopolize key pay television content is absolutely necessary to the economic viability of these businesses.

The need to ensure equitable access to content is not limited to pay television. A new entrant cannot rely on its competitors to deliver a product over the new entrant's network, particularly when the competitor is vertically integrated and controls the content. To the extent that its competitors have dominant positions in other vertical markets, the new entrant requires assurances that it will be able to access that content on terms and conditions that do not favor the incumbent.

In communications between SaskTel representatives and FoxTel, FoxTel has indicated that it would consider making its content available to other facilities based carriers in one of two ways:

- Firstly, it has suggested that it would access the network and sell to end customers in its own right.

- Secondly, it has suggested that it may be prepared to sell its content to network providers to aggregate and resell in their own right.

With regard to the first proposal, SaskTel International cannot take the risk of building a network that will rely to a large degree on Telstra, its main competitor, choosing to maximize distribution of product that it controls over a SI built network. Telstra as one FoxTel shareholder, and one which appears to have control over distribution of key content, would be motivated by a desire to see SI's market activities fail, especially where FoxTel has satellite as an alternative distribution technology.

With regard to the second offer, FoxTel has indicated that due to contractual commitments between its shareholders that give one of them a veto over certain of its content, it cannot make this content available to a competitive access network provider. It appears that the shareholder that would be reluctant to make the content available is Telstra. If such arrangements exist, and if Telstra is disposed to veto such distribution arrangements, then SI would submit that in refusing to make FoxTel content more generally available, Telstra is motivated more by the benefits it receives from blocking the construction of competing access networks than by the opportunity to earn an increased return from its investment in FoxTel, which would benefit from broader distribution of content. This is anti competitive behavior that tends to lessen the benefits to the Australian economy that would result from the construction of an alternative broadband access network.

New entrants must be able to offer a full complement of telecommunications products and services including pay television content and Internet connectivity at competitive prices. As long as the new entrant cannot gain the necessary content at reasonable prices and in a reasonable time, a vertically integrated incumbent has an unfair advantage. Current pay television programming arrangements must be reassessed. The ability of new entrants in regional markets to compete with Telstra is hampered by the fact that Telstra, through FoxTel, has chosen not to make content available to new entrants who desire to construct new networks, develop their own service offering and compete with Telstra. This circumstance needs to be re-evaluated in order to foster healthy competition and broaden consumer choice.

AN INDUSTRY SPECIFIC REGULATOR SHOULD BE CREATED TO SUPERVISE THE IMPLEMENTATION OF THE GOVERNMENT'S NEW POLICY

New, facilities based entrants require regulatory certainty. Regulatory policy and procedures must be established, evaluated and found to be acceptable before a new business will enter the market. Smaller entrants do not possess the necessary resources to engage in a prolonged regulatory battle against an entrenched incumbent or to accept the risks and uncertainty that relies upon general competition law to achieve what is the desired social policy of a government. This can best be achieved by a policy oversight of the incumbent, either by a specific regulator, specific legislation or a specific minister charged with responsibility to make conditions favorable for competition to develop.

Currently, new entrants must negotiate commercial agreements with Telstra and pay television content suppliers. These parties often compete with the new entrant and, therefore, have no interest in reaching commercial terms. New entrants have recourse to the general competition law to pursue their commercial objectives, however, general competition law is ill suited to effecting pro-competition policy. In fact, some actions that would tend to enable competition (e.g., choosing to offer time limited exclusive operating franchises as Britain did, or making a private commercial agreement generally known and available to all) may be contrary to general competition law. Furthermore, pursuing remedies under the general competition law is a private remedy available to only those new entrants with the deepest of pockets should an incumbent decide to avail itself of all of its statutory and legal rights. Once the regulatory body is created, its decisions should be public and applicable to all others in the industry.

Start-up ventures require protection from the aggressive and potentially anti-competitive responses of the incumbent. Experience has shown that unsupervised incumbents will attempt to prevent a competitor from getting established in a market. It has been noted that to even get into the business the new entrant must build a new network to compete with the incumbent. This takes a significant amount of time (a minimum of 9 months) during which the incumbent may sign customers in the area to longer term contracts and take other measures, such as creating or advancing technology deployment plans for the area, to secure that market only.

The incumbent already has a steady stream of income from its residential and business customer base. It has a significant vested interest in protecting its market. It can take steps to improve its network, its service offering and its price earlier than planned or only in the areas being built by the new entrant. It may also choose to bundle services with other broadband services provided by the other broadband providers. All of these actions, and others that are appropriate once competition has been established, can strike the new entrant when it is most vulnerable, causing failure or lackluster performance in the marketplace, ultimately depriving consumers the benefits of competition.

The regulator must also be capable of ensuring that the Federal policy is not thwarted by the actions, advertent or otherwise, of local Councils, state governments or governmental or private agencies such as power companies.

CONCLUSION

Effecting competition policy requires balancing differing interests. The balance of policy options and regulatory initiatives chosen to promote competition may differ from market type to market type across a country. The lack of development of competitive local access networks since the introduction of the new régime in 1997 is symptomatic of the regulatory risks and barriers that potential new entrants face when entering the Australian market.

Telstra continues to generate monopoly level profits. This is telling evidence that the current telecommunications competition policy has not succeeded. It appears that the Federal government has chosen to maximize the short-term financial return it receives from its ownership of Telstra at the expense of the more general, indirect and long-term benefits that the entire population of Australia would enjoy from the development of an effective telecommunications competition policy.

The Australian regulatory environment is very uncertain at the present moment. Basic necessities for interconnection and competition with the incumbent, such as the cost of originating access, are subject to appeal. Interconnection prices resulting from access disputes arising almost two years ago are still under appeal. Even if the appeals were complete, the industry would not benefit because the decisions are private matters between the two litigants. Services a new local exchange carrier would require from the incumbent have not been declared.

Developing the telecommunications infrastructure necessary to compete with an incumbent requires a significant investment over a prolonged period of time. The current balance of policy and regulatory initiatives will definitely have an adverse affect on a potential new entrant's investment decision. While they can be expected to take business risks, it is unreasonable to expect investors to accept regulatory risks while committing their funds to the development of competitive services.

SaskTel International has been assessing the possibility of making a network investment in rural and regional Australia since mid 1998. Successful development of this opportunity would likely lead to additional investment. The factors causing SaskTel International to delay entering the market have nothing to do with customer interest, technology costs, or construction difficulties, but with the current regulatory environment that does not appear to be designed to promote and facilitate facilities based competition.

SaskTel International understands that the process of regulatory review can be onerous, however, it is vital that the regulatory model be reassessed if competition is to thrive in Australia. More importantly, without access to advanced communication services, Australian residents, particularly those residing in rural and regional areas, will not be full participants in the new economy.

If the government truly desires to improve the competitive environment and promote the development of competition in local access networks, it must make its intentions known and take policy steps to support the desired objectives.

APPENDIX 1 – SASKTEL & SASKTEL INTERNATIONAL PROFILES

SASKTEL & SASKTEL INTERNATIONAL

SaskTel International is a wholly owned subsidiary of Saskatchewan Telecommunications (SaskTel), a telecommunications company that has been providing communications services to the residents of Saskatchewan, Canada for almost 100 years. SaskTel is the incumbent telecommunications service provider in the province and is 100 per cent owned by the province. Despite its ownership, it is still regulated by the Canadian federal telecommunications regulatory body. Among the many characteristics that make SaskTel unique is the fact that it is the last major telephone company in North American that remains government owned.

SaskTel provides service to an area covering over 640,000 square kilometres, serving a population of 1 million people in 380,000 homes and farms and 35,000 businesses. Saskatchewan's two largest cities, 250 kilometers apart, have populations approaching 200,000 and urban areas consisting of nearly 80,000 homes respectively. The remaining Saskatchewan cities, ten in total, have populations between 5,000 and 35,000, and between 2,200 and 15,000 homes respectively. The balance of Saskatchewan's population live on farms or in towns with populations under 5,000 - these towns and farms are dotted throughout the southern half of the province. The northern half of the province is largely uninhabited with a population of 50,000 mostly aboriginal people living in very small settlements dispersed throughout the north.

The province's vast geographic area and its widely dispersed population also distinguish SaskTel from most other North American telecommunications service providers. In fact, SaskTel has the lowest number of telephone accesses per kilometer of network infrastructure in Canada.

In spite of, or perhaps because of public ownership as well as Saskatchewan's challenging geography and population density, SaskTel has achieved a number of significant firsts in the deployment of advanced technology and the implementation of service improvements to the people of Saskatchewan:

- SaskTel was the first telephone company in Canada to have a fully digital network;
- SaskTel was the first telephone company in the world to offer a commercial high speed Internet service based on Digital Subscriber Line (DSL) technology;
- Building on its network development and desire to improve service in rural and regional areas, SaskTel has been at the forefront of offering universal Internet access to urban and rural customers;
- SaskTel built and operated cable television networks in Saskatchewan. When the regional and rural nature of the province proved to be a barrier to cable television operators building networks and providing service in Saskatchewan, SaskTel built cable television networks in the larger communities. It later sold these networks when they had acquired sufficient customers to be self sustaining and when the provincial and federal governments harmonized their telecommunications policy;

- SaskTel was the first telephone company in the world to introduce a long lines fibre optic network (deploying fibre optic transmission capacity to carry video and voice traffic in the early 1980's);
- With its Rural Individual Line Service program of the late 1980's, SaskTel was the first Canadian telephone company to eliminate multi-party lines, providing each resident of southern Saskatchewan with the benefits of an individual circuit to the central office (e.g., separate ringing for each customer, digital feature functionality, Internet accessibility from each residence);
- SaskTel was the first telephone company in North America to amalgamate local telephone exchanges and expand local calling areas in rural regions while preserving the customers local identity.

SASKTEL'S GLOBAL EXPERIENCE

SaskTel has adopted a diversification strategy to offset the adverse affects of competition in home markets, and SaskTel International is a key component of this strategy. Since its establishment in 1986, SaskTel International has successfully marketed SaskTel's extensive operational and technical expertise worldwide. Its work has varied from working as the lead contractor on the installation of the telecommunications system for the Channel Tunnel project in England, to commissioning telecommunications equipment for new entrants throughout the world, to providing advice and consulting services to governments and new entrants on six continents.

Through its varied work, SaskTel International has obtained significant expertise in advancing the development of telecommunications infrastructure and services in rural and regional areas. It markets and sells telecommunications facilities management software developed by SaskTel for small and medium rural, regional or dispersed telecommunications companies. SaskTel has also established regional offices in Tanzania and the Philippines, providing turn-key telecommunications networks and project managing rural telecommunications infrastructure initiatives in these developing countries since the mid 1980's.

Perhaps the most significant testimony of SaskTel International's experience in the development of rural and regional telecommunications infrastructures comes from the World Bank. It has asked SaskTel to provide policy and directional input as a recognized expert in the field of rural and regional telecommunications infrastructure development.

SI's activities are not limited to developing countries. It has also made significant capital investments in regional communications initiatives in developed countries. SI has made investments as the telecommunications partner in LCL Cable Communications in Leicester, England and was the original telecom partner in what is now Telstra-Saturn, New Zealand. In operating both of these investments SI designed, built and sold communications services on access networks that provided services in direct competition to the incumbent carriers, British Telecom and Telecom New Zealand.

COMPETITION IN SASKTEL'S HOME MARKETS

SaskTel understands the benefits of competition and the use of competitive forces to enhance services throughout rural and regional areas. In its home markets, data services have been fully competitive since the late 1970's; terminal and cellular competition since the late 1980's; long distance and Internet competition since the mid 1990's; and local access competition since the late 1990's.

As a result of the market initiatives of its competitors, SaskTel has improved its customer service levels and introduced more competitive pricing and service offerings. Residents of regional Saskatchewan (those living in cities and towns of less than 200,000 people) generally have access to the same service levels, pricing and products as their counterparts living in the largest cities. Although rural residents continue to press for service improvements such as high speed Internet access, they have the same access to customer service, call and feature pricing bundles, general service offerings and dial up Internet as their urban and regional counterparts. Customer satisfaction levels throughout Saskatchewan have risen from pre-competition levels to current levels where customers are more satisfied with SaskTel now than when the corporation held a monopoly on providing services to Saskatchewan residents. Without hesitation it can be said that competition has improved service and product offerings throughout Saskatchewan.

SaskTel International believes that the knowledge and experience that it has gained from its roles as:

- the incumbent telecommunications service provider in a large regional and rural area;
- a consultant to businesses and governments on rural and regional telecommunications start-ups and infrastructure improvement programs;
- an infrastructure builder in developing countries; and
- an investor, builder and new entrant telecommunications service provider in developed countries; uniquely qualifies it to observe and comment on the development of regional and rural telecommunications infrastructure and services in Australia.

As an incumbent service provider in its home market, SaskTel is acutely aware of the benefits that competition can deliver to markets, customers, the industry and the owners of the incumbent service provider. It is also aware of the economic and social costs to these interested parties of introducing competition in telecommunications markets.

SI proposes to construct a competitive broadband customer access network and offer dial-up and high-speed Internet, voice and pay TV services to the consumers, institutions and businesses of Lake Macquarie and Newcastle in competition with Telstra. Market research indicates this area is under-served by Telstra and SI believes this new venture would be well received. SI's commitment to the project is evidenced by the fact that it has spent significant sums of money and significant time in developing this particular business opportunity and is also evidenced by this very submission.

Although SaskTel believes that the comments and observations in this submission are made from an objective point of view, it must be borne in mind that SaskTel would like to make an investment in regional Australia and thus be perceived to be in a position of promoting its own interests. The very fact that SaskTel has been looking to invest in Australia for a number of years has enabled it to draw on actual experience in developing its views on the state of telecommunications competition regulation in Australia.