Macquarie Corporate Telecommunications Submission to the Productivity Commission in Response to the Draft Report

Introduction

Macquarie Corporate Telecommunications welcomes the opportunity to comment on the Commission's Draft Report. Macquarie is in broad agreement with the majority of the proposals contained in the Commission's Draft Report. In areas that impact directly on Macquarie's activities, comments have been provided in response to the Commission's requests for further information and/or in response to the findings contained in the Draft Report.

Macquarie's submission addresses the following areas:

- Part XIB anti competitive conduct
- Part XIC access regime
- The arbitration process
- Regional issues
- Industry Development Plans
- Pre selection

Part XIB anti competitive conduct

The commission proposes the removal of Part XIB and reversion to the generic provisions of Part IV of the Trade Practices Act. The grounds for this are that the provisions have been ineffective and rarely used. MCT does not object to the removal of Part XIB per se, but strongly objects to reverting exclusively to Part IV for relief from anti competitive conduct.

Part XIB was enacted in 1997 due to Part IV being perceived as inadequate to address conduct in the telecommunications sector. The telecommunications sector was distinguished from others by having a dominant incumbent, (Telstra still boasts that three out of four telecommunication dollars spent in Australia are spent with Telstra and that 90% of all profits from telecommunication services were made by Telstra in 1999/2000), and inherent network characteristics with complete reliance on interconnection to provide telecommunication services. In 1999 the distinguishing characteristics remained evident to such a degree that the provisions were strengthened.

There is no evidence that the sector characteristics have changed or in any way been ameliorated. Accordingly, it is not appropriate to revert to the pre 1997 position of exclusive reliance on Part IV.

Part XIB has not been used due to the procedural and evidentiary complexities and hurdles, not because there has been no experience of anti competitive conduct.

Essentially XIB requires the aggrieved party to demonstrate that the offending party has a substantial degree of power in the market and, secondly, that the conduct has the effect of substantially lessening competition in the market. The first arm is generally easy to satisfy however in most cases the second arm presents an insurmountable hurdle.

The aggrieved party must evidence that competition has substantially decreased which requires evidence that one or more providers have left the relevant market or their market share has dramatically diminished; in practice this requires complete market failure. Most providers offer a full range of telecommunication services and strategically cannot afford to withdraw from a service. Accordingly, providers will incur a loss to remain in a market. In the event that the provider has been forced to withdraw from the market, it is generally too late for an XIB notice to provide any remedy.

If it can be demonstrated that there is a significant loss of market share, the aggrieved party must then evidence that the loss has occurred as a direct result of the offending party's anti competitive conduct. This requires evidence that customers have ceased purchasing the service from the aggrieved party and commenced to purchase from the offending party. This will require information that is exclusively in the possession of the offending party and therefore not available. Further, it must be established that the transfer of customers resulted from the anti competitive conduct and not as a result of other attributes of the service, perceived or otherwise. This is largely a subjective issue requiring information from the customer, which is also not necessarily available to the aggrieved party.

Insistence by Telstra for confidentiality in all contracts and proceedings not only delays the XIC process but also frustrates XIB proceedings by restricting the evidence available to frustrated parties. For example it is impossible to pursue an XIB proceeding for acts in the government or corporate markets where all pricing is "commercial in confidence' and therefore unable to be relied upon in evidence.

Part IV contains similar evidentiary requirements on a generic basis, although Part IV is even more onerous as it requires establishing that the purpose of the conduct is anti competitive whereas Part XIB merely requires that the effect or likely effect of the conduct is anti competitive. The 1999 amendments attempted to implement a more expedient process however this has not been successful.

MCT proposes that a telecommunication specific provisions be retained with a simplified competition notice enforcement process. This would apply when an access or service provider is in control of an element essential to a party seeking interconnection or provision of a service, and the party is perceived by the ACCC to use that control in an anti competitive manner. Whilst this would give the ACCC a considerable degree of discretion it would provide more targeted and unambiguous powers to intervene in disputes.

MCT believes such powers are warranted given the propensity for anti competitive conduct in the market. Recurring examples of conduct that XIB has failed to remedy include:

- Bundling whereby monopoly services such as local calls are priced at below cost and sold in a bundle with competitive services such as long distance
- Discriminatory provisioning where infrastructure providers give preferential service to their own retail customers over their own wholesale customers. This is particularly prejudicial in the initial connection of services.
- Internet interconnection or "peering" under which the four major network providers are "peered" and terminate each other's traffic free of charge. All other operators that terminate on any of these four networks must pay a termination charge although no payment is made when a "peer" terminates on a "non peer's" network.

Part XIC Access Regime

MCT supports the Commission's recommendations in respect of Part XIC however in general MCT believes additional measures to those proposed are required to ensure the objectives of Part XIC can be efficiently met.

The amendments that MCT seeks to comment upon are:

- tighter criteria for the declaration of services
- abolition of the TAF
- sunset terms for declarations
- open arbitrations
- reference pricing
- arbitration time limits
- updating determinations
- reciprocal terminating charges

Declaration process

Declaration Criteria
MCT supports the introduction of prescribed criteria for the declaration of services and believes that the criteria proposed by the Commission are appropriate. (8.24)

TAF
The TAF has proved ineffective and will remain devoid of consensus due to the divergent commercial interests of its members, the dominant access providers and access seekers. Accordingly, the TAF should be abolished and the declaration process administered solely by the ACCC.

The other function of the TAF, drafting and maintaining the TAF access code, should be undertaken by ACIF. This task should involve an advisory panel operating under the auspices of ACIF, with a simple, focused role to produce standard terms and conditions of access to infrastructure and services. Once agreed by a majority of the panel, the

standard terms and conditions could be registered by the ACCC having the effect of making the terms and conditions a mandatory benchmark.

Sun Setting of Declarations
In respect of the sun setting of declarations, it is generally accepted that all market regulation should have a defined life. However, MCT is concerned that setting end dates without provision to prolong the period may result in regulatory "gaps." This could occur where sun set dates are prescribed in the expectation of technological development or take up by the market which may be delayed or not occur. As an example, the take up of ULL services has fallen well behind the rates predicted 12 months ago. If the local carriage service declaration was to sunset at the end of 2001 in expectation that the ULL would be providing alternative services, Telstra would revert to having an unregulated monopoly of local call services until such time as viable alternatives became available.

Another frequent cause of delay in the implementation of declarations is the time between declaration and the outcome of an arbitration that will implement the regulated terms of provision. All bottle neck services declared have generally suffered a two to three year delay between declaration and arbitrated outcome. In the case of the Local Call Service, three years have elapsed since declaration and yet there is no final implementation of a price reflecting the declaration. Unless the sun setting provided for this lag time, incumbents would be free to harvest monopoly rents and declaration would be ineffectual.

MCT therefore proposes that sun setting of declarations is subject to review by the ACCC and, where it believes that the service continues to meet the declaration criteria, the ACCC can extend a declaration for up to six months beyond the sunset date. A public inquiry would not be required.

Arbitration process

Open arbitrations
MCT supports the Commission's proposals for amending the arbitration process but urges the Commission to completely open up the arbitration process. MCT proposes the adoption of open arbitrations that would provide the outcomes sought by the Commission in addition to a further degree of transparency.

In effect the Commission is proposing processes which are available to parties in the normal judicial process but, inexplicably, are denied to aggrieved parties in the telecommunication sector. Open arbitrations are merely a further step towards parity with the judicial processes. Open arbitrations would reduce the number of telecommunication arbitrations brought before the ACCC, currently in excess of thirty, by providing precedents on methodology, terms and pricing. Fuelled by multi party arbitrations with parties able to share costs and information, precedents would quickly be established.

MCT acknowledges that open arbitrations may result in detriment to one or both parties through the disclosure of commercial information. However it is always open to parties to negotiate a confidential bilateral arrangement. Any perceived risk associated with disclosure provides an incentive currently lacking in regard to encouraging parties to attempt to negotiate terms outside of the arbitration process.

Alternatively access providers can provide an undertaking to the ACCC which, if accepted, would remove the threat of arbitration by access seekers. To date there have been no undertakings accepted by the ACCC. Clearly the legislative framework intended that undertakings would provide precedents that are currently lacking. The threat of open arbitration may prompt the provision of undertakings on reasonable terms or, failing this, open arbitrations will provide precedents in any event.

The Commission however perceives three disadvantages with fully transparent, open arbitrations. (9.35) The first is that open arbitrations may reveal the commercial plans of access seekers and providers, the second is that open arbitrations allow external scrutiny of negotiation arrangements between parties and the third is that open arbitrations remove the proprietary nature of efficient contracts. These disadvantages are of limited materiality as most arbitrations are over price and not broader contract issues. To the extent that an arbitration may reveal commercially sensitive information, the parties can agree to address these issues outside of the arbitration or within the arbitration in camera.

Regardless of the materiality of the Commissions perceived “disadvantages”, to date Telstra has been a party to every arbitration and therefore has the advantage of access to all the information that the Commission believes should not be disclosed. Maintaining closed arbitrations therefore ensures that this information asymmetry is maintained in Telstra's favour and, on the basis of the Commission’s views, gives Telstra an advantage over all other sector participants.

In any event the issue of disclosure of contracts is somewhat moot as Telstra’s dominance allows it to dictate contract terms and, as a consequence, the non-price terms of access contracts are all very similar if not identical.

Reference Pricing

In the event that open arbitrations are not introduced, MCT believes that the compromise proposed by PowerTel (9.35) is preferable to the existing arbitration and undertaking process. PowerTel’s proposal establishes a reference-pricing regime with the ACCC relying on the information provided by the parties to the initial arbitration. Reference pricing is certainly a good solution for interconnect services and should reduce the frequency of disputes once the pricing is set.

However, the inherent difficulty with a floor and ceiling price as proposed is that the incumbent will always demand the ceiling price, justifying this on volume or other cost variables. The access seeker will have limited or no information on the cost variables and will therefore need to resort to arbitration to be satisfied it is paying a fair price. Open

arbitrations would reduce the likelihood of this occurring as relevant volumes and other cost variables influencing the arbitrated price would be accessible.

Regardless, either alternative is preferable to the current regime, which relies on pricing principles that are of very limited value without information on access provider's costs. Telstra refuses to release its costing information and, where it is compelled to, release is subject to strict and pedantic confidentiality obligations restricting its use to third party advisors and the arbitration in question.

Time limits

The Commission proposes non-binding time limits on arbitrations to provide more expedient arbitrations and earlier relief to the market. MCT believes that non-binding time limits will not be effective. The incumbent has every motive to delay proceedings and retain the status quo. In MCT's experience Telstra has actively delayed proceedings by flaunting ACCC prescribed deadlines for submissions and responses. In addition, when requested to provide information Telstra consistently raises issues of confidentiality. The issues invariably require submissions and responses and, once resolved, result in a prolonged negotiation of confidentiality deeds before Telstra will finally provide the information and allow the proceedings to continue.

Given Telstra's current disregard for the ACCC's time tables and its overt delaying tactics, MCT believes non-binding time limits would be flaunted and therefore pointless. If time limits are to be imposed they should be mandatory however MCT recognises that enforcement would be difficult.

Updating determinations

MCT supports the Commission's proposal for a mechanism to allow determinations to be varied over time to remain in line with the market.

It is logical that a determination should cease to apply when the relevant declaration ceases. Theoretically declaration will cease when the market conditions no longer require regulation due to there being a sufficient level of effective competition in the market. In the presence of effective competition market rates should be available and therefore a determination is no longer required as the only impact it could have would be to maintain a price out of line with the market.

Whilst a declaration continues, determinations should be adjusted to reflect any movement in the market caused by a shift in demand or supply or new technology. How to amend the determination is problematic. A glidepath will lock in any regulatory error and/or fail to reflect any major shift in the market. Linking the determination to domestic pricing may not be appropriate given that many markets are immature and may not provide an indication of price trends. Similarly international benchmarks may not reflect the Australian market that has certain idiosyncratic dynamics and characteristics. Given the inherent flaws in these mechanisms, periodic review by the ACCC may be the only effective mechanism however, the confidential nature of the arbitrations and pricing in

general may mean that the ACCC has limited market knowledge to apply to any variation.

Two way access
MCT strongly supports PowerTel's proposal of reciprocal terminating charges for like services. (10.35) Reciprocal terminating charges provide an equitable solution where there are network operators of differing size and one way access charging constitutes a significant barrier to entry. A current example is the internet peering regime that governs Australian domestic internet traffic under which the four major network providers are "peered" and terminate each other's traffic free of charge. All other operators that terminate on any of these four networks must pay a termination charge although no payment is made when a "peer" terminates on a "non peer's" network.

Reciprocal terminating charges for internet traffic would provide a more equitable regime, reduce the inherent advantage of the "peers" and encourage new entrants. Settlement may be cumbersome however charges could be offset referring to different bands of prices based on volume levels to accommodate varying volume related costs. In respect of internet traffic, the current "peering" regime would need to be dismantled and reciprocal terminating imposed, as it is most unlikely that the major providers would enter into such arrangements voluntarily.

Regional

The Commission acknowledges that there are divergent levels of competition between the regional and metropolitan and CBD markets. However the Commission rejects MCT's proposal for the appointment of a regional Communications Commissioner as being unnecessary due to the ability of the ACCC to declare services on a geographic basis that allows regional markets to be regulated and other markets to be exempt.

Specifically, the Commission is concerned that a regional commissioner may result in over regulation and unnecessary intervention. However whilst asserting that the current regulation is adequate, the Commission acknowledges the existence of differing service and competition levels between metropolitan and regional markets. If it is accepted that the regulation is adequate, the administration of the regulation must therefore be wanting and hence a regional specific administrator, such as a regional commissioner, may well be warranted.

Industry Development Plans

MCT supports the Commission's recommendation that Industry Development Plans (IDP) be removed as a condition of obtaining a carrier license. The preparation of an IDP requires considerable resources and can delay the granting of a license. (Negotiating its IDP with the Department delayed the granting of MCT's license by four months.) Both

the resources required to prepare an IDP and report annually together with the delay in obtaining a license constitute barriers to entry, particularly to smaller providers.

In addition, the value of the IDP as a means to promote useful telecommunications investment is questionable. The telecommunications carrier and service provider industry has changed significantly in recent years however the requirements for industry development have remained the same. The need for infrastructure development has now arguably been met and the industry has evolved with the majority of carriers providing service through wholesale infrastructure access plus elements of their own niche infrastructure combined with creative value adding services. The definition of acceptable research and development activity however continues to stress "hardware" elements and ignores software and service developments that now dominate the industry.

If the IDP requirement is not abolished it should at least be unshackled from the carrier license criteria and refocused to address current sector requirements.

Pre selection

MCT considers that pre-selection has provided significant benefits to access seekers and to consumers in supporting and facilitating the introduction of competition into the telecommunications market. MCT believes these benefits should be enhanced and furthered with more services being made preselectable and, as a matter of priority, with the introduction of multi basket pre selection as soon as this is technically feasible.

In respect of the allocation of responsibilities for administering pre selection, MCT considers it important in the longer term for there to be a clear line of responsibility for administering pre selection and transparent methodology to determine whether services should be pre selected. If it is assumed that pre selection promotes competition and ultimately benefits end users, all services should be made preselectable if it is technically and commercially feasible to do so. Accordingly there is no role for the ACCC. The only criteria for preselectability are whether it is technically and commercially feasible and, accordingly, the ACA is best placed to make and implement this decision.