7 August 2000

Professors Michael Woods and Richard Snape
Telecommunications Inquiry
Productivity Commission
PO Box 80
BELCONNEN ACT 2616

Dear Commissioners,

SUBMISSION OF AAPT LTD TO TELECOMMUNICATIONS INQUIRY

I refer to the Productivity Commission's *Issues Paper* of June 2000 for the Review of Telecommunication-Specific Competition Regulation ("Review"). I am pleased to present AAPT Ltd's Submission to this Review.

AAPT's principal submission is that current telecommunications-specific competition regime is effective, fair, efficient and should be retained. The past three years have seen significant growth in the telecommunications industry in Australia, resulting in increasing consumer benefit. Much of this has been enabled by the telecommunications-specific competition regulation provided in Parts XIB and XIC of the *Trade Practices Act 1974* ("**TPA**") and related provisions in the *Telecommunications Act 1997* ("**TA**").

AAPT believes that these legislative regimes are soundly based, and would support the regulators making more use of the powers which have been provided (and recently extended) by Parliament. AAPT submits that it would be premature for Parts XIB, XIC or other competition-related provisions of the *Telecommunications Act* to be repealed or significantly curtailed.

Following is a summary of AAPT's main submissions.

Elements of the telecommunications-specific competition regime

Part XIB of the TPA

Part XIB has been important as both a preventive measure and as a cure to anti-competitive conduct in the telecommunications industrly. The unusual nature of telecommunications markets, particularly when moving from a monopoly structure to full competition, requires

the existence of significant industry-specific rules and powers. The ACCC's role in safeguarding competition has been greatly enhanced by Part XIB in this respect.

Moreover, AAPT's experience strongly suggests that Part XIB has been a significant deterrent to anti-competitive conduct that may have occurred if that Part had not been introduced. The existence of the "effects test", the heavy potential penalties, and Competition Notice regime have undoubtedly had an effect of decreasing the likelihood of anti-competitive conduct by those carriers with market power.

The information-gathering rules give the ACCC essential powers to obtain information from carriers in order to detect anti-competitive conduct. AAPT believes that these provisions do not require amendment, although it does believe that the ACCC should be encouraged to use these powers more assertively.

Part XIC of the TPA

Part XIC has been a successful and important mechanism in the development of competition in Australian telecommunications markets. It has enabled the opening of many telecommunications markets to competition by ensuring that new entrants have an adequate footing to compete with incumbents, while also providing proper safeguards to the legitimate interests of incumbents. AAPT considers that the current LTIE test in Part XIC reflects an appropriate balance between the interests of access seekers and access providers.

Part XIC has also helped to produce a dispute-resolution regime that avoids the rigidity and cost of litigation and gives carriers a more structured forum for resolving disputes. Here too, AAPT's only significant concern is that the powers provided under Part XIC should be more extensively used.

For the above reasons, AAPT strongly supports the full retention of the current Part XIC provisions.

Telecommunications Act 1997

AAPT believes that the this legislation has generally been beneficial to competition in the telecommunications industry. The rules in the TA on number portability, pre-selection and technical standards have all been positive for end-users, and have fostered conduct by carriers that they may have otherwise been slow to engage in. AAPT supports the retention of these provisions of the TA.

Overall themes developed in the Submission

Competition is yet to broaden and deepen

The effects of the current regime have been felt most dramatically in market segments with high concentration: primarily business services and long distance voice services. Many of these gains have been the result of the combination of regulatory policy and investment

incentives. AAPT believes that the existing telecommunications regime must be preserved in order to ensure that all Australians benefit from strong and effective competition.

Access-based competition leads to infrastructure-based competition

AAPT rejects the claim often made by incumbent carriers that the existence of an access regime may hinder investment. Overall, AAPT's experience is that it is in those markets where access services have promoted competition, investment opportunities are created. The most efficient way to secure facilities-based competition is to allow new entrants to first build a customer base using access services. This provides the incentive for investment, the means of securing funding and the experience to efficiently employ those funds in new networks.

The administrative costs of the regime are less than alternatives and is more fairly distributed.

The costs are shared fairly because all carriers are required to contribute on the basis of revenue, rather than allowing the costs to fall inequitably on the victims of anti-competitive conduct. These obligations should be extended to carriage service providers and other loopholes should be closed.

The competition protections need to be made stronger not weaker.

Carriers which possess market power have adapted to the advent of competition by seeking to protect the markets in which they dominate and to leverage this power into related markets (such as Internet access and content). In order to deal with these issues, the Productivity Commission should consider new mechanisms to control the extension of power into evolving markets.

Further inquiries

As outlined above AAPT believes the core issue for the Review is the extent to which the current regulatory regime (in Part XIB, Part XIC and certain provisions of the Telecoms Act) meets the Government's policy objectives. In that regard the key issues are the development of competition and efficient investment in infrastructure.

AAPT has commissioned economic studies in relation to these two issues and intends to address issues arising out of these in supplementary submissions.

AAPT looks forward to participating at the public hearings to be held this month.

Thank you for considering AAPT's submission. Please contact me on (02) 9377 7121 or David Havyatt on (02) 9377 7694 if you have any queries in relation to the submission.

Yours sincerely,

Brian Perkins
Group Director, Regulatory and Legal

INITIAL SUBMISSION BY AAPT

TO THE PRODUCTIVITY COMMISSION REVIEW

OF TELECOMMUNICATIONS SPECIFIC COMPETITION REGULATION

7 AUGUST 2000

This submission is made by AAPT Limited ("**AAPT**") to the Productivity Commission ("**Commission**") Review of Telecommunications Specific Competition Regulation ("**Review**"). This is an initial submission and AAPT expects to participate in the first round hearings scheduled for early August and also to make one or more supplementary submissions.

No material in this submission is confidential. Where AAPT has provided confidential information to the Commission this fact is noted in the submission but the material has been forwarded separately.

The structure of this submission is as follows:

1. background and general observations about the telecommunications industry, government policy and the terms of reference of the review

2. responses to the issues raised in the Commission's issues paper. These responses indicate where AAPT expects to make supplementary submissions.

3. AAPT's overall comments on other matters that AAPT considers relevant that have not been otherwise addressed.

INTRODUCTION AND GENERAL OBSERVATIONS

AAPT is pleased to make this submission to the Review.

The reform of telecommunications in Australia has been continuous since the establishment of Telecom Australia as an independent commission in 1975. There have been several important milestones on the reform path. These include the review of aspects of Telecom's operation in the Davidson Inquiry of 1982, the launch of the AUSSAT satellite system, the corporatisation of Telecom as part of the 1988 GBE reforms and the introduction of limited competition and a regulator in 1988. This process of change led to the introduction of a second general carrier with the *Telecommunications Act 1991*, and culminated in the introduction of open competition in 1997 under the *Telecommunications Act 1997* ("**TA**").

This development of telecommunications regulatory arrangements is important because the policy decisions taken at each stage have been dependent on the decisions at earlier stages. The extent to which the policy decisions of each stage have been effective has been a key factor in defining the scope for further policy development.

Purpose of the Review

The purpose of the Review should be considered in the context of this process of reform. An examination of the Terms of Reference makes this clear.

> *The Terms of Reference for the Commission's current review refer telecommunications specific competition regulation for inquiry and report (reference 1). While the Terms of Reference require specific examination and reporting on a number of specific provisions (Reference 4) it also is required to "have regard to the intent of the Parliament in establishing the review, the state of competition in the telecommunications market and the impact of new technologies and delivery platforms" (Reference 2).*

The Terms of Reference also make it clear that the Review's scope is limited to the competition question within the context of "the established economic, social and environmental objectives of the Australian Government." In Reference 4(b) the Commission is required to "examine and report on the community and economic benefits and costs" flowing from the existing provisions.

AAPT considers that the Commission has two responsibilities in the conduct of the review:

- to advise the Government on how effective the telecommunications competition provisions have been in implementing the Government's policy objectives; and

- to assesses whether these provisions need to be maintained, repealed or amended to continue the achievement of the Government's policy

objectives. If the Commission is of the view that it wants to recommend the repeal of the telecommunications specific provisions, it would need to specify changes to general competition law to ensure that particular competition issues raised by network industries are addressed.

The Commission in its Issues Paper identified the boundary limits of the review:-

> *It is important to remember that the inquiry is looking at the telecommunications-specific competition regulation, and other matters will only be considered to the extent that they are relevant to competition in the telecommunications market and the regulation of that competition.* (AAPT's emphasis.)

Government policy objectives

The Government's objectives in relation to telecommunications regulation are set out in s.3 of the TA, which reads:-

> *Object*
>
> (1) The main object of this Act, when read together with Parts XIB and XIC of the *Trade Practices Act 1974*, is to provide a regulatory framework that promotes:
>
> (a) the long-term interests of end-users of carriage services or of services provided by means of carriage services; and
> (b) the efficiency and international competitiveness of the Australian telecommunications industry.

The relevant section of the *Trade Practices Act 1974* **("TPA")** is section 152AB, which states:-

> *Object*
>
> (1) The object of this Part is to promote the long-term interests of end-users of carriage services or of services provided by means of carriage services.
>
> *Promotion of the long-term interests of end-users*
>
> (2) For the purposes of this Part, in determining whether a particular thing promotes the long-term interests of end-users of either of the following services (the ***listed services***):
> (a) carriage services;
> (b) services supplied by means of carriage services;
>
> regard must be had to the extent to which the thing is likely to result in the achievement of the following objectives:
> (c) the objective of promoting competition in markets for listed services;

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

(e) the objective of encouraging the economically efficient use of, and the economically efficient investment in, the infrastructure by which listed services are supplied.

Subsection (2) limits matters to which regard may be had

(3) Subsection (2) is intended to limit the matters to which regard may be had.

Promoting competition

(4) In determining the extent to which a particular thing is likely to result in the achievement of the objective referred to in paragraph (2)(c), regard must be had to the extent to which the thing will remove obstacles to end-users of listed services gaining access to listed services.

Subsection (4) does not limit matters to which regard may be had

(5) Subsection (4) does not, by implication, limit the matters to which regard may be had.

Encouraging efficient use of infrastructure etc.

(6) In determining the extent to which a particular thing is likely to result in the achievement of the objective referred to in paragraph (2)(e), regard must be had to the following matters:

(a) whether it is technically feasible for the services to be supplied and charged for, having regard to:

(i) the technology that is in use or available; and

(ii) whether the costs that would be involved in supplying, and charging for, the services are reasonable; and

(iii) the effects, or likely effects, that supplying, and charging for, the services would have on the operation or performance of telecommunications networks;

(b) the legitimate commercial interests of the supplier or suppliers of the services, including the ability of the supplier or suppliers to exploit economies of scale and scope;

(c) the incentives for investment in the infrastructure by which the services are supplied.

Subsection (6) does not limit matters to which regard may be had

(7) Subsection (6) does not, by implication, limit the matters to which regard may be had.

Achieving any-to-any connectivity

(8) For the purposes of this section, the objective of any-to-any connectivity is achieved if, and only if, each end-user who is supplied with a carriage service that involves communication between end-users is able to communicate, by means of that service, with each other end-user who is

> supplied with the same service or a similar service, whether or not the end-users are connected to the same telecommunications network.

There are no objects expressed in the legislation for Part XIB but, in his Second Reading Speech, the then Minister for Communications, the Information Economy and the Arts gave three reasons for not relying solely on Part IV:

- the significant market power Telstra continued to enjoy derived from its historical monopoly position;
- the scope for any incumbent to engage in anti-competitive conduct, especially cross-subsidy practices; and
- the concern that the fast pace of development in the industry meant that anti-competitive behaviour could cause rapid damage to the competition that has already developed and to severely hamper new entry.

Put simply, the principal objective is the promotion of the long-term interests of end-users ("**LTIE**"). In determining whether a thing promotes the LTIE, there are three criteria set out in the TPA:

- the promotion of competition;
- the encouragement of the efficient use of, and investment in, infrastructure; and
- the achievement of any-to any connectivity.

Each of these needs to be well understood.

Promoting competition

The idea of competition is well understood in ordinary competition regulation, as the *process* of rivalry between suppliers in a market. It is usually explained using economic concepts such as efficiency and social welfare.

AAPT supports the view of competition explained by the Trade Practices Tribunal in the QCMA decision, that is:

> *Competition expresses itself as rivalrous market behaviour. In our view effective competition requires both that prices should be flexible, reflecting the forces of demand and supply, and that there should be independent rivalry in all dimensions of the price-product-service packages offered to consumers and customers.* [1]

[1] *Re Queensland Co-operative Milling Association Ltd and Defiance Holdings Ltd* (1976) ATPR 40-012 at 17,246.

The use of the phrase "promoting competition" extends the traditional analysis beyond the mere *prevention* of anti-competitive conduct. In determining the extent to which something is likely to result in promoting competition "regard must be had to the extent to which the thing will remove obstacles to end-users of listed services gaining access to listed services." This definition is wider than a standard market definition and reflects the key feature of telecommunications regulatory requirements.

This definition reflects the fact that telecommunications is a network business where activity is two-way, and access to other networks is required to deliver service in the first network. This is related to the any-to-any connectivity issue. But connectivity is only the start, it is meaningless if the terms and conditions (in particular price) of that connectivity are prohibitive. It is the objective of promoting competition that ensures that the any-to-any connectivity can be attained in a way that should make the decision of a customer about which network to join efficient in the economic sense.

The network effect is a critical feature of telecommunications economics. Regulation needs to take account of this effect, and should ensure that competition between service providers is not distorted by the numbers of consumers served by their respective networks. Therefore, when assessing how well this objective is being met it is not sufficient to measure the state of competition in markets but also the extent to which choice of network is independent of the size of the network and the market power of the network operator.

Efficient use of and investment in infrastructure

This element of the LTIE test is complex. There is a tendency to focus on one component of the test, which is the role of incentives to invest. However, the test also refers to the *use* of infrastructure, which reflects the concern that there may be instances of telecommunications infrastructure that represent the characteristics of a natural monopoly. In these circumstances, it is important that the access regime allows the infrastructure to be used by those carriers and CSPs who can most efficiently supply downstream services which utilise the infrastructure.

In other words, the objective of the legislation has been to promote neither "service based competition" nor "facilities based competition" as a preferred model. The objective is to achieve competition through the appropriate models depending on the circumstances. Most specifically, the objective reflects the typical and most efficient pattern for the introduction and promotion of competition which involves new entrants first acquiring customers and then investing in infrastructure.

To ascertain the extent to which the objective is being achieved, it is certainly necessary to review the nature of investment in the industry. However, the pattern of investment needs to be based on a full understanding of the objective.

Any-to-any connectivity

The test of any-to-any connectivity is the defining distinction between telecommunications markets and other markets involving access. The requirement will be discussed in more detail later.

The key distinguishing characteristic of any-to-any connectivity is that it breaks down the concept of upstream or downstream markets, especially in relation to terminating access. The ability of one network to enable its customers to connect to the customers of another network does not entail an upstream or downstream market in the sense of stages of production. They are two parallel production streams that operate together.

Review Objectives

The Commission's principal objective should be to review how effective the regime has been in regard to delivering the Government's policy objectives. The review will need to consider how, if at all, the regime could be amended to improve the achievement of the Government's policy objectives. AAPT notes that section 151CN of the TPA specifically requires that a review of Part XIB be commenced within three years of its commencement.

AAPT believes that any reduction in the legislative safeguards imposed by either Part XIB or Part XIC would be premature and inappropriate. Although some aspects of the telecommunications market have become competitive since 1991, the overall market has not developed to anywhere near the level that would warrant the partial or full repeal of Parts XIB and XIC. The government's policy objectives, set out in sections 3 of the TA and 152AB of the TPA, are a long way from full realisation.

Market Developments Prior to 1997

The Government specifically acted to introduce competition in stages, with the licensing of an additional general carrier and a third mobile carrier under the *Telecommunications Act 1991*.

The merger of Telecom and OTC into what became Telstra, created a formidable and highly integrated incumbent on the cusp of the introduction of competition. The then Government's rationale was that the new entity would be able to develop as a significant global telco. The Government reasoned that, as Australia was relatively early in de-regulating its industry, the experience of competition gained at home would place Telstra well to compete globally. It was accepted that, without the experience of effective competition at home, Telstra could never successfully compete globally.

As early as 1993 Telstra was forecasting that within three years $2 billion of revenue would be generated overseas.

It is acknowledged that Telstra's international growth strategy has so far been less than successful. While there are a number of reasons that can be advanced for this, a large contributing factor has been the slowness with which competition has developed in Australia. Telstra has not actively supported the promotion of competition and therefore has not developed experience necessary for it to compete elsewhere. This matter is raised because, in the Commission's terms of reference it is expressly excluded from recommending any structural separation of Telstra. The Commission can, however, pass comment on how successful the alternative strategy has been.

Alignment of Telecommunications Regulation

While the Commission's primary focus must be on assessing the effectiveness of the current regime in meeting policy objectives, it will clearly also report on the likely future regulatory requirements.

The case for telecommunications-specific competition regulation was clear cut in 1997. AAPT believes the case for such regulation remains the same in 2000 and for the immediate future.

The alternative to telecommunications-specific regulation is usually seen to be a reliance on the existing general competition provisions of the TPA. However, as the Commission itself noted in its recent report on Broadcasting[2] these provisions may not be sufficient to ensure competition is protected in communications industries. In the case of broadcasting, the Commission found that the particular policy objectives should be recognised in dealing with mergers and acquisitions in the converging media industries. In addition to the industry-specific legislation itself, there is also a need for industry-specific regulators whose expertise allows them to take prompt and effective action where necessary. The current roles of the ACCC and the ACA should be maintained.

AAPT believes that the new economy industries, such as telecommunications, present challenges for the regulation of competition and that the experience in telecommunications provides some useful pointers for generic regulation.

The first is the need to deal with access issues in network industries. Increasingly, new economy markets demonstrate these network elements whereas traditional manufacturing models do not. The second is the need to recognise the issue of the rate of change in the industry, the relative ease of accumulating market power, and the ease with which competition can be damaged. These conditions indicate the requirement to have more effective provisions than Part IV of the TPA in any circumstance similar to that prevailing in telecommunications.

2. PRELIMINARY RESPONSE TO COMMISSION ISSUES PAPER

This section responds to the various questions posed by the Commission in its issues paper. The consequences of the matters raised here are considered together with other matters in the third section, which relates back to the objectives of the review.

Issues have been grouped within the framework of the issues paper for ease of discussion. Boxed items include the items from the Commission's discussion paper to which the response relates.

[2] Productivity Commission, *Inquiry into Broadcasting*, April 2000, p. 359

2.1 The need for telecommunications-specific competition regulation?

Definition of telecommunications

The Commission seeks views on the widening scope of the term "telecommunications".

The significance of the characteristics of telecommunications is economic as well as technical. However, the definition of "telecommunications" used in the TPA is derived from the technical definition in the TA.[3] AAPT acknowledges that the approach to the definition of telecommunications should encompass more of the technology-neutral factors which influence competition, rather than the technical nature of telecommunications networks.

The technologies which comprise the telecommunications industry are changing and will continue to do so. Governments and regulators must be alert to these developments and change the regulatory framework where necessary.

The Commission has asked whether network effects might emerge in other industries, like broadcasting. The answer is that network effects already exist in a number of markets typical of the new economy, most notably in the ISP market, electronic funds transfer, "B2B e-commerce" and in many content services.

The Commission is right to identify that the experiences in telecommunications regulation might have application beyond telecommunications in the regulation of the new economy. From this observation, one conclusion which may be drawn is that the scope of the telecommunications regime should be extended by widening the definition.

Definitional changes based on the technological characteristics of particular industries may, for instance, include some broadcasting technologies which, although in many ways similar to telecommunications technologies, are distinct and will remain so for the foreseeable future.

[3] A number of relevant defined terms are used in both the TPA and the TA (such as "carriage service", "carriage service provider"), however, the definitions generally refer back to the basic definition of a ***telecommunications network*** which is defined as "a system, or series of systems, that carries, or is capable of carrying, communications by means of guided and/or unguided electromagnetic energy" (TA, section 7).

Barriers to competition

> ***To what extent do these or other characteristics have the capacity to limit competition significantly and in which market segments?***
>
> ***Are there other characteristics of the telecommunications industry that suggest a need for industry-specific competition regulation? If so, in which areas of the industry?***

The Commission points to the following characteristics that could impede competition in the telecommunications industry:

- large lumpy investments;
- network externalities;
- economies of scale and scope; and
- a dominant integrated incumbent in the market.

AAPT will address these factors and the two questions in the following passages.

Large lumpy investments

AAPT considers the lumpiness of telecommunications investments creates significant advantages for incumbent networks over new entrants. In addition to the simple fact that large investment is required, incumbents possess important financial and informational advantages in relation to investment decisions.

In general, new entrants will not possess the same internal financing options open to large incumbents which, at least in the Australian market will generally have greater cash reserves and cash flow than their smaller rivals. In obtaining access to debt or equity finance, new entrants will generally pay a premium for funding because of the perceived greater risks faced by smaller carriers – resulting largely from the incumbents' competitive advantages discussed elsewhere in this section. Accordingly, the lumpiness of investment will often exacerbate the advantages possessed by incumbents, particularly where investments must be made quickly.

The investment risks to smaller carriers are also exacerbated by a lack of information about market conditions. For newer networks, large investments must often be made in new markets and may be based on new technologies (such as AAPT's LMDS investment) in order to compete with installed networks. The information available about market demand will often only be available to incumbent networks. Often an incumbent will seek to further distort market information and discourage entry by temporarily altering market conditions through strategic conduct such as below-cost pricing, or by itself investing in excess capacity.

Further comments on efficiency in relation to lumpy investments are provided below. AAPT is conducting research on investment issues in telecommunications and will offer additional comments in later submissions.

Network externalities

From a microeconomic perspective, the key feature of a telecommunications network is the presence of a network externalities (or effects), which are the benefits that each member of a network gains from additional members joining the network. While the value of the network externality to individual existing users may be low, the significance in competition terms is the perceived benefit to potential new users which, in turn, creates the value of telecommunications networks to owners.

Network effects create welfare improvements which may not be fully reflected in prices. As with many other externalities, even a competitive market may fail to fully incorporate the value of the network effect in the price of the network.[4] Inefficiencies may be introduced such as the network externality being under-recovered or (more likely) network operators seeking to recover the value of the network from new users or other network operators wishing to interconnect.

As with a natural monopoly, there is the danger that a network monopolist will reduce the value of the network to society as a whole as it attempts to appropriate a bigger share of the value to itself, by raising prices or engaging in strategic conduct.[5]

There are two results which arise from the presence of network externalities which are of particular relevance to the Review:

- the competitive advantage which accrues to large incumbent networks;
- the difference in the value of interconnection to large networks versus small networks.

These are discussed below.

(i) *Competitive advantage accruing to large, installed networks*

A useful approach to network effects is to consider them as demand-side economies of scale.[6] A traditional (supply-side) economy of scale exists when the average costs of production fall as production volumes increase. The demand-side equivalent is that the average per unit value to consumers rises as more units of output are consumed. In the same way that economies of scale create efficiencies by reducing costs,

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[4] One instance where this occurs is where a hardware or other fixed price is required to access the network. As the number of users grows, the network operator may be unable to charge existing users for the benefits they receive from the network effect.

[5] For example, the anti-competitive effect of exclusionary contracts may be more pronounced in relation to network industries (see C Shapiro, "Exclusivity in Network Industries" (1999), 7 George Mason Law Review 1).

[6] see Shapiro and Varian, Information Rules, p.179

network effects may affect efficiencies by increasing the value of a network to consumers.

As with supply-side economies of scale, the relevance of network effects to competition analysis is that they act as a barrier to new entry because the aspiring supplier must enter on a large scale to be competitive. The barrier becomes higher as the number of users on the existing network increases, making it even more attractive – an effect commonly referred to as "positive feedback". This is particularly relevant in the case of two-way communications networks.

In the case of telecommunications, positive feedback is often encouraged by pricing which favours "on-net" calls over "off-net" calls. For example, some mobile networks offer on-net calls at substantially lower prices (or zero prices) compared to calls to or from other networks. A result of such pricing is that consumers will tend to favour larger networks over smaller networks, because of the increased likelihood that the consumer will be making calls on-net in a larger network.

If all networks start from the same base, the presence of network effects may promote competition. However, where large incumbent networks exist competition may be dampened because network externalities will allow the large or incumbent networks to resist the entry of new, more efficient networks.

(ii) *Differential value of interconnection*

For the reasons set out above the incumbent network has little incentive to interconnect with a new entrant network. On the other hand, a new entrant must interconnect with the incumbent otherwise it will not be able to attract customers. In the absence of appropriate access regulation, this differential value of interconnection will flow through to the terms and conditions of interconnect and adversely impact the promotion of competition. The history of the development of telephone networks in the US from 1885 to 1913 demonstrates the way this network externality drives a competitive market towards monopoly.[7]

In Australia, the ACCC's issuing of Competition Notices against Telstra in relation to Internet peering provides a good example of the anti-competitive effect of the differential value of interconnection.

Economies of scale and scope

It is well recognised that economies of scale and scope create barriers to entry by requiring that new entrants also operate on a scale and scope which may be difficult or impossible for them to obtain in many instances. AAPT notes that the Commission (then the Industry Commission) commented extensively on these issues in its report *Telecommunications Economics and Policy Issues* (March 1997) and agrees with the comments offered there.

[7] see Brooks J, *Telephone: the first one hundred years*, (Harper & Row, New York, 1976)

Although there is some argument as to whether any telecommunications networks can technically be considered "natural monopolies", AAPT considers that, regardless, many exhibit pronounced economies of scale and scope. This is particularly so in relation to the important ubiquitous networks, notably the local loop and national mobile networks.

Presence of a dominant, vertically-integrated incumbent

A vertically-integrated incumbent has the capacity to use its power in one market to act anti-competitively in other markets. An example would be the incumbent setting wholesale charges which do not allow rival carriers which seek interconnection to offer a competitive retail price. Vertically-integrated carriers can engage in more traditional forms of anti-competitive conduct, such as discriminatory pricing, cross-subsidisation or constructive refusal to deal. Such conduct could often be challenged under Part IV of the TPA (although sector-specific competition regulation would still be far more effective in such cases.) However, given the distinctive features of the telecommunications industry (particularly network effects) it may be difficult to show that conduct such as bundling or the use of customer and/or competitor information would be prohibited by a strict application of Part IV. Nonetheless, such conduct is open to vertically-integrated incumbents in the telecommunications market, and requires special regulation., particularly where the incumbent has a greater than 90% market share (as Telstra did in the recent past).

Other factors

A further factor which AAPT considers competitively significant is the speed of development in the industry.

(i) *Magnifying the effect of anti-competitive conduct*

Although rapid change can be pro-competitive if new technologies develop in such a way as to undermine market power, it can also serve to magnify the detrimental effects of anti-competitive conduct.

The transition from a duopoly to an openly competitive market occurred very quickly in the telecommunications industry. The incumbent was extremely large compared to its rivals and, while those rivals have gained market share since 1997, the discrepancies in market power remain large, as the Commission notes. Simultaneously, the development of the Internet and other technological developments further increased Telstra's size in terms of traffic revenues and investment. Telstra also remains the only carrier which supplies services in all major product markets.

The telecommunications-specific legislation was introduced partly because reliance on Part IV remedies would take too long and that, in a market as rapidly-changing as

telecommunications, such delay could effectively mean that anti-competitive conduct would have an even worse effect than in a more traditional, stable market.[8]

(ii) *First-mover advantages*

When considered in the context of network industries, rapid change may also create significant "first mover advantages". A first mover advantage occurs when the provider that is first to the market gains a competitive advantage.

In most cases first mover advantages should not be the subject of regulation. First movers are often those who have innovated or taken a risk. The competitive advantage that the first mover obtains is a legitimate and necessary part of the incentives to undertake innovative and risky activities. Similarly, economies of scale may make first movers more efficient than smaller rivals. Regulation in such cases would be counter-productive.

However, regulation should address first-mover advantages obtained by mere incumbency or where a carrier which possesses substantial market power engages in strategic conduct to secure and leverage the advantage, such as by delaying access to essential services or imposing artificial increases in the cost of switching between providers. Examples of such regulation in telecommunications are mandating number portability and pre-selection. This denies the first mover the competitive advantage and reduces the incentives for the first mover to deny these services even if it is efficient to do so. If these services are efficient, regulation has a role to ensure their implementation, enabling rivals to compete based on their relative merits.

Are there important regional aspects to effective competition in telecommunications and, if so, how do existing regulatory arrangements aid or hinder such competition?

The development of competition has generally been slower in regional and rural markets than in metropolitan and CBD markets, because demand is usually thinner and greater per capita investments per head are required. These characteristics mean that to date regional markets have been akin to local monopolies. Such circumstances may lead to market failure and investment in telecommunications at lower levels than is required to deliver optimal outcomes.

Under these circumstance efficient service provision in regional areas may hinge on the degree of market contestability rather than the degree of observed competition. AAPT considers the issue of the delivery of competition to regional and rural areas as important for the Review to examine. This may require the analysis of alternative models of competition in these markets. AAPT intends to address these issues in later submissions on the basis of the economic studies it has commissioned.

There has recently been significant interest by the Government and rural communities in ensuring the delivery of new communications services. AAPT has sought to

[8] This characteristic was also specifically noted in the Minister's Second Reading Speech to the Trade Practices (Telecommunications) Amendment Bill.

participate in this process by undertaking significant investment programs in regional Australia, notably the VicOne network in Victoria. Also relevant to this process is the work currently being conducted by the Department and the ACA into competitive tendering of USO services.

Also of note is the recent announcement from the Online Council that a series of case studies are to be conducted to develop a regional telecommunications model toolkit. The purpose of the toolkit is to assist regional and rural organisations improve access to telecommunications services for their communities.

The current regulatory regime potentially aids in the development of these various types of models by, for example, ensuring that regional providers can access essential inputs required to compete for supply arrangements. The competitive conduct provisions of Part XIB are also likely to assist by reducing the likelihood of anti-competitive conduct once the preferred supply arrangements are determined.

However, the successful adoption of these approaches may require more interventionist approaches on the part of the Government and a greater willingness to engage in direct regulation of service standards.

Are there any legal or constitutional barriers to developing the most appropriate system of competition regulation in the telecommunications industry?

AAPT is unaware of any legal or constitutional barriers to developing the most appropriate system of competition regulation. The constitutional power over telecommunications matters is clear from section 51 of the Constitution. Of course, in relation to the decision-making powers of the regulators, administrative and constitutional limitations apply. However, AAPT does not believe that any of the recommendations and comments contained in this submission would be invalidated.

AAPT also notes that Australia is, at least in principle, bound by the Fourth Protocol to the General Agreement on Trade in Services ("**GATS**"),[9] which states that parties should implement effective competition and access regimes in the telecommunications industry. The specific commitments Australia has made include introducing measures to counter anti-competitive conduct and to guarantee interconnection for new entrants on fair and non-discriminatory terms.

AAPT believes that the GATS commitment would not be fully met by relying on Part IIIA and IV of the TPA. The specific issues raised under the GATS are covered in the relevant sections of the submission below.

[9] Fourth Protocol to the General Agreement on Trade in Services, signed at Geneva on 15 April 1997, binding on Australia from 8 December 1998 These provisions are found in the 'Schedule of Specific Commitments' agreed to by Australia. Available on internet at Austllii Treaties Library: http://www.austlii.edu.au/au/other/dfat/treaties/1998/9.html

Is industry-specific regulation the most appropriate way of addressing any barriers to competition in the telecommunications industry? For example, what would be the effect of relying on the general provisions for anti-competitive conduct in the TPA? Would there be a need for any changes to regulation under the Telecommunications Act if telecommunications-specific competition regulation under the TPA were amended or removed?

These issues are discussed in response to other questions asked in the Issues Paper. AAPT will be in a position to provide more detailed submissions on these points following the completion of the economic research projects it has commissioned.

Are there efficiency consequences from promoting a competitive telecommunications market, particularly as it relates to recovering the costs of lumpy components of the network?

In competitive telecommunications markets, productive efficiency may be affected in some instances where new networks may not have the economies of scale that are characteristic of a single, incumbent network. AAPT argues that any loss of productive efficiency, however, is outweighed by improvements in allocative and dynamic efficiency.

AAPT further submits that productive efficiency is improved by the existence of a mandatory access regime. For reasons elaborated in the discussion on access an effective access regime allows new entrants to make efficient build/buy decisions. Assuming that access prices are cost-based and include reasonable estimates of competitive returns on capital, such a regime will not result in distortions in favour of facilities or service-based competition

Investments which appear viable *ex ante* may turn out to be inefficient, unprofitable, or otherwise undesirable. Investors may not receive a normal return from their investment in a certain network or facility. At the same time, however, such experiences have the effect of informing rivals, and the market generally, about what kinds of investments are likely to succeed. This is an instance of dynamic efficiency being promoted. In a competitive market, carriers are also more likely to target particular services for which demand is high and which they are best placed to provide. This has the effect of promoting allocative efficiency.

In regard to lumpy investments, it is true that some lumpy components of networks may not ultimately produce a return which covers the historical costs of investment. However, such outcomes may be economically efficient. A competitive market will allow the full recovery of efficient investment costs but will not allow carriers to recover where alternative investments are more efficient. As already stated, AAPT considers that, even if productive efficiency may be affected in a competitive market in some instances, this is equalled or outweighed by improvements in allocative and dynamic efficiency.

The Commission has expressed a concern that regulation which seeks to reproduce competitive market conditions may not allow efficient cost recovery of investment, particularly where excess capacity exists. This issue received close attention during

the development of the 1997 telecommunications regulatory package and, more recently, has been addressed in the context of the ACCC's consideration of pricing principles to be applied in relation to access to non-dominant PSTN networks and GSM termination.

An argument often put by network owners is that discriminatory pricing, particularly Ramsey pricing, offers efficient means of recovering the large investments required to establish telecommunications networks. Implementing policies of discriminatory pricing may be difficult or impossible in competitive markets, if the presence of a number of suppliers will often forces prices to cost-based levels.

AAPT is undertaking further work relevant to this issue and will provide further comments. However, at the outset, AAPT notes that where services are provided by vertically-integrated suppliers which possess market power it will be difficult for regulators to distinguish efficient discriminatory pricing and strategic or monopolistic discrimination.

In such circumstances, AAPT considers the correct approach should be that, where claims of investment recovery through discriminatory pricing are made, the carrier making the claim must be able to verify that the policy is supported by available data and that the policy is *dynamically* efficient. In the absence of such proof, AAPT argues that competitive surrogates should be applied in all markets, other than those in which the other conditions of Ramsey pricing apply – notably where profits are regulated.

How could the regulatory environment be structured so as to gain efficient cost recovery outcomes while maintaining the expected benefits from increased competition?

The current regime strikes a balance between formal legal rights and obligations on one hand (such as the Competition Rule and the Standard Access Obligations) and regulatory discretion on the other (such as the arbitration/undertaking regime and the choice of Competition Notices). AAPT supports this balance between binding and discretionary approaches.

In AAPT's view, the regulatory environment, by emphasising cost-based pricing of access, is already appropriately structured so as to allow efficient recovery of all reasonably incurred long-term investment costs, while encouraging competition in both access and downstream markets.

The role of convergence

> ***What impact will future developments (such as technological and enterprise convergence) have on the need for or form of industry-specific competition regulation? In which market niches?***
>
> ***To what extent will the growth of alternative networks increase competition and reduce (or increase) the need for competition legislation in some areas? How rapidly will this occur?***

Although much has been made of the "convergence" of telecommunications with other technologies, such as broadcasting and information technology, precise definition of the process is difficult. The European Commission ("**EC**") *Green Paper on Convergence*[10] identified two immediate results of convergence:

- the ability of different network platforms to carry similar kinds of services; or
- the coming together of consumer devices such as the telephone, television and personal computers.

In relation to the Review, AAPT considers the first result is the more significant. The *Green Paper* also discussed various forms of convergence: technological, industrial (services and markets) and regulatory. In the consultations which followed the release of the *Green Paper*, the EC found general acceptance that technological convergence is already underway. Industrial (or enterprise) convergence is also increasing in Europe as strategic alliances and mergers between communications and media companies become more common.

More difficult is how regulation should address convergence. The principal overall conclusions reached in the EC's Communication to the European Parliament following the Green Paper consultations were that sector-specific regulation was still required and that competition rules must be applied on a case-by-case basis.[11] This approach has clearly been taken up in the EC's proposed legislative changes which have been released recently.[12] For the reasons dicussed throughout this submission in relation to individual legislative provisions, AAPT considers it appropriate to retain the existing industry-specific provisions.

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[10] European Commission, *Green Paper on the convergence of the telecommunications, media and information technology sectors, and the implications for regulation: towards an information society approach*, COM (97) 623, 3 December 1997 (available at: http://www.ispo.cec.be/convergencegp/greenp.html).

[11] European Commission, *Communication to the European parliament, the Council, the Economic and Social Committee and the Committee of the Regions: the convergence of the telecommunications, media and information technology sectors and the implications for regulation*, COM (1999) 108, 10 March 1999 (http://www.ispo.cec.be/convergencegp/com(99)108/com(99)108enfinal.html).

[12] European Commission, *Proposal for a Directive of the European Parliament and of the Council on a common regulatory framework for electronic communications networks and services*, COM (2000) 393, 12 July 2000

This approach recognises that, while technological and industry changes may ultimately require a change to regulation, anticipating such changes and pre-emptively changing regulations may be harmful. Rather, the regulatory approach should be based on principles which are technologically and organisationally neutral. The regulators should be given sufficient discretion and powers to apply these principles on a case-by-case basis.

In Australia, AAPT submits that the process of convergence is at a much earlier stage and, consequently, the case for retention of sector-specific competition regulation is stronger. Further, the smaller scale of Australia's communications markets (where such national markets exist) justifies a precautionary approach in competition regulation.

In some cases, alternative networks will provide competitive constraints to incumbent networks. However, for the reasons discussed in the early sections of this submission, the advantages of incumbency are generally substantial in the developmental stages of network competition and may, in fact, never be completely removed. In instances where incumbent carriers are themselves permitted to roll out new networks, market power is frequently transmitted from one market to another.

AAPT submits that the development of competitive alternatives to Australia's incumbent networks (particularly in regard to the "last mile") is, at best, nascent. In such circumstances, it would be highly damaging to retract sector-specific regulations.

How should telecommunications "markets" be defined for regulatory purposes?

AAPT believes that conventional market definition principles are generally adequate and should continue to be applied when defining telecommunications markets. However, there may also be a need to supplement traditional techniques with consideration of strategic factors in market definition.

There is no definition of the composite term "telecommunications market" in either the TPA or TA, although the individual words are defined. The definition of "telecommunications" is discussed above. Section 4E of the TPA defines markets in terms of the substitutability or competitiveness of goods and services. The more detailed analysis of markets is traditionally conducted by the consideration of several dimensions to the market – product, geographical, functional and temporal markets.[13] In Australian practice, a "purposive" approach is taken to market definition, which requires a consideration of the competition problem being analysed, before the markets can be defined.[14]

AAPT argues that no specific definition of telecommunications markets should be introduced into the legislation. We believe, however, that there have been some mistaken regulatory approaches to market definition. For example, the fixed-to-

[13] see ACCC, *Merger Guidelines* (June 1999) pp 31-42.

[14] Re *John Dee (Exports) Pty Ltd* (1989) ATPR 40-938 at 50,219; G de Q Walker, "Product Market Definition in Competition Law", (1980) 11 *Federal Law Review* 390.

mobile service has generally been defined as part of the mobile telephony market, when in fact it appears to belong more naturally to the fixed telephony market since these calls originate in the fixed network.

With regard to the effect of convergence on the definition of telecommunications markets, we believe that the definition of telecommunications should not be amended. In particular, we believe that defining telecommunications to include, for example, broadcasting services, may have the effect of artificially blurring the distinction between such services ahead of actual convergence of these markets.

Definition of telecommunications services should be done, as it has been so far, on a case by case basis, with due regard to the distinctive features of the market in question. This approach would allow broadcasting services to be included in a telecommunications market definition if there was, in fact, a reasonable level of convergence and substitutability between them.

2.2 Evaluating the existing telecommunications-specific competition regulation

2.2.1 General issues for regulatory design and implementation

The essential elements of an effective regulatory system are:

- simplicity – the effect of the regulations should be easily understood, both to aid enforceability and to allow certainty of outcomes to ensure that efficient investment and consumption are not discouraged. As a practical matter, even the simplest of regulations may become unnecessarily complicated when put into practice, and simplicity in the statement of regulations can ease their implementation;

- enforceability – it should be possible to ensure that the goals of regulation have been achieved, as this aids the credibility of the regulator and discourages attempts to subvert the regulation. Enforceability forms the basis for the rationale for regulatory powers such as information gathering regimes, which ensure that directives have been acted on and that any regulatory controls have been designed and their levels set properly; and

- incentive compatibility – regulation should not give a firm an incentive to invest or price inefficiently, or to discourage it from undertaking profitable and welfare-improving activities.

2.2.2 Specific issues about existing regulations

Anti-competitive conduct

Why should there be a "second route" for averting anti-competitive behaviour specific to the telecommunications industry under the TPA?

The Competition Rule and Competition Notice regime in Part XIB was introduced because of the special features of the telecommunications industry. In mid-1997, Telstra and Optus had an effective duopoly, challenged by a much smaller AAPT and a few other carriers.

The factors which, in AAPT's view, justified the introduction of the "second route" have already been discussed. The Minister's Second Reading Speech placed particular emphasis on the importance of the regulatory regime being responsive:

> *"Total reliance on Part IV of the TPA to constrain anti-competitive conduct might, in some cases, prove ineffective given the still developing state of competition in the telecommunications industry. The fast pace of change and complex nature of horizontal and vertical arrangements of firms operating in this industry mean that any anti-competitive behaviour could cause rapid damage to the competition that has already developed…"*[15]

While the overall appearance of the telecommunications industry has changed since then, there are still important parts of the industry which remain affected by competition to only a small degree. In particular, the fixed local telephony market remains dominated by Telstra, with over 95% of local call customers signed with that carrier. Telstra still has substantial market power in a range of telecommunications markets, particularly in wholesale markets.

The inclusion of an "effects test" in a misuse of market power provision[16] was an unprecedented development in Australian trade practices law. In contrast with section 46, it did not require that any purpose to damage or eliminate competitors be shown. In this respect also, the Minister noted that the reliance on a purpose test may "unduly delay regulatory action to stop anti-competitive conduct". Of course other forms of anti-competitive conduct dealt with under Part IV were also deemed to breach "the Competition Rule".[17]

Another new development was the introduction of the "Competition Notice",[18] which could be issued by the ACCC against a carrier which behaved anti-competitively, and which was prima facie proof of such an allegation. AAPT endorses Part XIB, and in

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[15] p. 2.

[16] Section 151AJ(2)

[17] Section 151AJ(3)

[18] Section 151AK

particular the competition rule and the Competition Notice. The past three years have shown, in AAPT's experience, that Part XIB is an effective and important piece of regulation in the telecommunications industry.

In 1999, the Competition Notice regime was supplemented to include provision for notices to be issues in relation to anti-competitive conduct of a specified *kind*, rather than a particular instance of such conduct. The regime also now includes provision for the Commission to issue "advisory notices" which may specify action a carrier should take to avoid continuing to engage in conduct in breach of the competition rule.

The amendments were made in response to industry submissions to increase the ACCC's powers. The fact that the amendments were made indicates a clear Parliamentary view that the factors which led to the introduction of the telecommunications-specific competition regime were not only still relevant in 1999, but justified strengthening of the regime. Further, AAPT notes that the amendments were passed with bipartisan support.

AAPT considers that the structure the telecommunications markets today has not sufficiently developed or improved since 1999 to justify a reduction in the competitive safeguards. The market structure is unlikely to become much more competitive in the medium term.

What has been the impact of these provisions, including their potential deterrence of anti-competitive behaviour?

Since the regime's commencement on 1 July 1997, Competition Notices have been issued in regard to only two matters and litigation under Part XIB has been instituted on one occasion. However, the fact that the provisions have rarely been used does not necessarily imply that they have been ineffective – indeed, that fact is equally consistent with the proposition that they have reduced the incidence of anti-competitive conduct which might otherwise have taken place.

AAPT's view is that the provisions have been partly successful in this way. However, AAPT is also of the view that Telstra has engaged in instances of anti-competitive conduct which have not been adequately addressed under Part XIB, either because the ACCC formed the view that the available evidence was insufficient to establish a contravention, or because Telstra had partly changed the conduct without removing alleviating the substance of the anti-competitive conduct.

The first Competition Notice was issued in relation to Telstra's non-reciprocal charging for Internet "peering". The notice was revoked when Telstra and the complainants entered into negotiated arrangements. Notices were also issued in relation to Telstra's commercial churn process, after complaints by industry participants, including AAPT. The ACCC instituted proceedings in the case, before it was settled in February 2000.

In both these matters, AAPT believes that the resolutions probably would not have been achieved had Part IV been the only avenue of redress.

Even in situations where no formal action is taken, the existence of the competition rule has enabled AAPT to bargain more effectively with Telstra than would otherwise have been possible. It is clear that potential penalties of $10 million per contravention plus $1 million per day are a deterrent to anti-competitive conduct.

The more competitive environment fostered by Part XIB has, in AAPT's view, resulted in tangible benefits for end-users across Australia. The market needs to become more competitive still, but competition has been protected in the past three years much more than if new entrants had only had Part IV to rely upon. Section 46 is notoriously difficult to prove, and anti-competitive behaviour, even if unintentional, can have a devastating effect on competition in a market where there is one vertically-integrated, dominant firm.

Do the provisions have adverse or positive effects on investment in infrastructure?

It is difficult or even impossible to accurately measure any impact that Part XIB has had on investment. However, AAPT considers that any effect is overwhelmingly positive, and our experience bears this out. The industry as a whole has shown a strong commitment to invest in the past three years, as the following examples illustrate:

- CBD cables – Optus, AAPT, PowerTel and others;
- mobile telephony – Orange, Telstra, Optus, One.Tel and AAPT;
- wireless local loop – AAPT and Orange; and
- inter-capital transmission – Macrocom, PowerTel, UeComm, Soul Pattinson Telecommunications and Nextgen.

These are some of the major new infrastructure projects which have either commenced or have been completed recently. In many cases, the investment has occurred where the services have been declared.

Part XIB (in common with competition laws generally) does not prohibit the possession or attainment of substantial market power where that power is obtained by operating more efficiently than rivals. It is only the *taking advantage* of such power, with either a proscribed purpose (under section 46) or the effect of substantially lessening competition (under section 151AJ(2)), that is prohibited.

AAPT itself has not felt reluctance to invest, develop new services or otherwise act because of the existence of Part XIB – as the examples given above demonstrate. AAPT's preparedness to invest was influenced by the fact that there were specific provisions in Part XIB that protected carriers from a misuse of market power. For example, AAPT has recently committed a large amount of capital to developing its own mobile telephone network. AAPT would not have made this investment had it been concerned that anti-competitive conduct (such as predatory pricing, or anti-competitive exclusive dealing) by other carriers could go unchallenged.

Even if firms with market power refrain from investing as a result of mistaken views about the impact of Part XIB, any such shortfall has probably been made up by rivals, such as AAPT, investing in their own facilities. These investments made by new entrants are likely to be efficiency enhancing, because they are likely to rely on new technologies. Moreover, the data available for recent years supports the view that Part XIB has had a positive effect on investment. The past few years have been characterised by high levels of capital investment and it is likely that the competitive safeguards imposed by Part XIB, have encouraged new entrants (especially small firms) to invest in infrastructure. This is because new entrants have greater confidence that they will be protected from anti-competitive conduct.

Are Competition Notices an appropriate mechanism for initiating action? Are the criteria used for deciding whether to initiate a Competition Notice appropriate?

AAPT believes that the Competition Notice regime has been and is effective. One advantage of the Competition Notice regime is that it allows the ACCC to notify a party that its conduct is anti-competitive, without necessarily requiring litigation to be commenced. This gives the recipient an opportunity to amend or cease the conduct before any litigation commences. This is what happened in the Internet peering matter after the notice was issued against Telstra. The issue of the notice resulted in a faster and more satisfactory outcome than if the ACCC or other affected competitors had had to institute proceedings under Part IV.

AAPT supports the introduction last year of Part A and Part B Competition Notices. A Part A notice need only specify a kind of anti-competitive conduct, and is not prima facie proof of a contravention of the competition rule. This notice can be issued more quickly by the ACCC than the former type of notice, or what is now a Part B notice, as the degree of specificity required is lower. AAPT also supports the retention of section 151CC, which allows a private party to sue for loss or damage suffered when a Competition Notice is in force.

AAPT supports the provisions that allow the ACCC to give non-binding advisory directions to a party if a Part A notice has been issued, which should mean that the regime can be responsive and promote quicker resolutions rather than necessarily requiring the ACCC to pursue costly and protracted litigation.

In issuing a Competition Notice, the ACCC is still bound by administrative law rules and its Competition Notice Guidelines.[19] In issuing a Competition Notice, the ACCC has stated that it will consider four key objectives:

- compliance with the competition rule (and other provisions of the Act), and, in particular, the cessation of anti-competitive conduct;
- improvement in market conduct generally by carriers and carriage service providers

[19] ACCC, *Telecommunications – Competition Notice Guideline*, August 1999, p. 5

- the protection of consumers from the adverse effects of anti-competitive conduct and a community informed about the operation of the Act in telecommunications markets and the implications for business and consumers; and

- efficient and effective use of the ACCC's resources.[20]

The ACCC has identified factors for and against the issue of a Competition Notice in relation to each of these objectives. The weight given to each factor will vary depending on the nature of the conduct. AAPT believes that these factors and outcomes are appropriate and satisfactory and submits that they should be retained.

Have Part A notices resulted in a speedier process for dealing with anti-competitive conduct? Are any additional amendments warranted, and if so, what form should they take?

To date, no Part A Competition Notices have been issued. However, the provision for their issue is sound. The Part A notice does not require the same degree of specificity as required for a Part B notice. As a result, conduct which could attract a Part A notice can be investigated, and a notice issued, more quickly than conduct which might attract a Part B notice. Because of the lower standard of proof, a Part A notice is not prima facie proof of its contents. A Part A notice is thus a useful instrument in providing timely intervention where required.

AAPT would also suggest that the ACCC be given powers to issue "cease and desist" orders, either in conjunction with a Part A or B notice, or independently. Both the Federal Communications Commission and the Federal Trade Commission in the United States have powers to issue cease and desist orders relating to a wide range of conduct, including breach of licence conditions, legislation or any rule or regulation which the FCC or FTC is authorised to make.[21] The burden of proof is on the regulator to demonstrate that a cease and desist order is warranted. The agency must normally give the subject of the proposed cease and desist order notice of the proposed order an opportunity to respond.

The power to issue cease and desist orders would enable the ACCC to identify specific instances of anti-competitive conduct, and then direct a carrier or carriage service provider to stop such conduct immediately or at a designated time. This power could be bolstered by the threat of pecuniary penalties if the conduct continues after the order is issued (or another, future date). Cease and desist orders would have an immediacy and effectiveness that Competition Notices lack. Of course, administrative law would apply to decisions to issue such notices.

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[20] ACCC, *Telecommunications – Competition Notice Guideline*, August 1999, p, 5

[21] For example, section 312 of the US Telecommunications Act 1996 (47 USC 5) provides that:

> Where any person has failed to operate substantially as set forth in a license, has violated or failed to observe any of the provisions of this chapter… or has violated or failed to observe any rule or regulation of the Commission authorized by this chapter or by a treaty ratified by the United States, the Commission may order such person to cease and desist from such action.

There have been very few Competition Notices issued — how is this to be interpreted?

As discussed above, competition notices have been issued in regard to two matters. AAPT considers that, given the extent of arguably anti-competitive conduct by carriers with substantial market power, the lack of Competition Notices indicates either that matters have been otherwise resolved (such as through arbitration under part XIC) or that the regime needs further strengthening.

Although there was no explicit standard (threshold) for issuing a Competition Notice prior to July 1999, the fact that the Notice needed to refer to a specific type of conduct and that the Notice was prima facie proof of its contents implicitly required the ACCC to have a reasonably high level of evidence of a breach prior to issuing a Notice.

The few instances in which notices have been issued indicate that the Competition Notice regime, and Part XIB generally, can have and has had a positive effect in promoting competition in the telecommunications market. Moreover, it is possible (and perhaps probable) that the conduct in these matters would not have amounted to a breach of section 46 (or any other section) of Part IV of the TPA, meaning that it would have been unimpeachable if Part XIB had not existed. AAPT supports the retention of the Competition Notice regime and submits that competition would be enhanced by the introduction of "cease and desist" orders.

Are there other important differences between Part IV and Part XIB and what impact do these differences have?

AAPT notes that the competition rule essentially incorporates most of the prohibitions in Part IV, and adds one distinctive prohibition, notably the "effects test" for misuse of market power contained in section 152AJ(2). This means that a breach of the Part IV provisions listed in section 151AJ(3) constitutes a breach of the competition rule. The Part IV prohibitions which are *not* included in Part XIB, are:

- sections 45D, 45DA, 45DB, 45DC, 45DD, 45E, which prohibit secondary boycotts in certain situations; and

- sections 50 and 50A, which prohibit mergers resulting in a substantial lessening of competition.

Sections 45D through to 45E are mostly relevant to industrial disputes and appear to have little relevance in commercial contexts.

The merger provisions (sections 50 and 50A) are adequate in themselves and, as high profile mergers are usually considered by the ACCC prior to execution, there seems little benefit in applying the Part XIB enforcement regime.

As already discussed, AAPT believes that the competition rule, and the Competition Notice, have important substantive and procedural benefits which are not available under Part IV alone. For this reason, Part XIB should be retained, with the amendments suggested above.

Tariff filing and record keeping rules

Are record keeping requirements an appropriate and effective form of regulation for this industry?

To what extent should such information be made public? Is the information made public appropriate both in scope and content?

How significant is the cost to firms of being required to maintain and provide records? Is such information over and above what would be collected for commercial reasons?

What sort of information should be required to be kept?

How ought this information be used to regulate the industry?

Has there been sufficient use of these powers by the ACCC?

The reasons for the original inclusion of tariff filing and record keeping rules given in the Second Reading Speech which accompany the Trade Practices Amendment (Telecommunications) Bill 1996 remain valid today. The Minister noted that the ACCC "will need strong information–gathering powers to enable it to effectively administer competition regulation in the telecommunications industry".

In AAPT's experience, information asymmetry will in most instances support or cloak anti-competitive conduct of carriers which possess market power. As noted elsewhere in this submission, it is vital that the regulator be able to act quickly to stop anti-competitive conduct and an important means by which this can be achieved is by the regulator being confident that relevant information is available.

The ACCC has not as yet instituted any Record Keeping Rules. A draft has been circulated of financial Record Keeping Rules that are designed to capture costs in relation to the provision of declared services to assist the ACCC in the conduct of arbitration. The ACCC has indicated that these Record Keeping Rules will be issued as a draft instruction for public consultation by the end of August, and that a final instruction will be issued in October.

Telstra has on-going tariff-filing obligations, but only in relation to basic carriage services (under section 151BTA of the TPA). The discretionary tariff-filing rules (section 151BK of the TPA), which can be used only where the carrier in question has substantial market power has, to our knowledge, not been used by the ACCC, or only sparingly used.

The ACCC has as yet only issued a discussion paper on non-financial Record Keeping Rules and these relate more to the question of market shares both by traffic volumes and value.

The ACCC has not used the powers extensively to date, relying instead on the Chart of Accounts ("**COA**") and Cost Allocation Manual ("**CAM**") reporting obligations developed by AUSTEL. Nevertheless, the ACCC has been active in consulting with

the industry on an appropriate model for record keeping rules and, should the need arise, the use of record keeping rules is likely to greatly assist in the efficient execution of the ACCC's enforcement role.

With respect to the Commission's questions as to what information should be required and how that information ought to be used, AAPT's considers that this is an appropriate matter for the regulator's discretion. The answer to these questions will vary, depending on the prevailing competitive circumstances and the carrier or CSP which is subject to the requirements. Obviously, there is a greater need to require extensive internal cost information from carriers with substantial market power.

AAPT believes that the financial record keeping rules will provide useful cost data to the ACCC but that decisions on arbitrations need to be based on forward looking costs, not historical cost. In relation to information about the market this would be useful but could be obtained by the ACCC at any time under its powers under section 155. Such disclosure would at least help to expose any attempts to conceal anti-competitive internal cost transfer arrangements.

In particular, the use of section 155 rather than Record Keeping Rules can create an incentive for a carrier or service provider to evaluate its own behaviour. If a participant cannot provide data under section 155 to demonstrate that their behaviour is not anti-competitive, then the ACCC could use that failure as prima facie evidence that the behaviour is anti-competitive. This places the onus on the participant to keep such records as they think appropriate.

Something that is lacking in the records kept under legislation is data concerning the overall market. For example, there is no clear, publicly-available information on such things as market share or market growth, which would be useful to regulators, carriers and the public in assessing trends in the telecommunications market. Such data, if available in the public domain, would also assist the ACCC to determine more readily whether any conduct was anti-competitive. The mere fact that such data existed may also make carriers more reluctant to behave anti-competitively as their conduct could be scrutinised more readily.

AAPT believes that the current information-gathering powers are adequate and the ACCC should be encouraged (and appropriately resourced) to utilise these powers more extensively.

Access regulation

Before addressing the Commission's specific questions relating to the access regime in Part XIC of the TPA, AAPT notes that there are strong arguments for the retention of the whole of Part XIC.

First, the legislative requirement to review the telecommunications-specific competition regime in section 151CN is limited to Part XIB of the TPA. Parliament's decision not to include Part XIC, indicates that it did not consider a review of Part XIC would be necessary after three years. Of course, AAPT does not suggest

that it is inappropriate for a review to be conducted, however, it does indicate that Part XIC was intended to be more permanent than Part XIB.

Further, when Parliament last turned its mind to the legislation last year, it elected to strengthen the provisions in the access regime, rather than to diminish them. In other parts of this submission AAPT discusses the importance of the new amendments, such as the addition of the power for the ACCC to make interim determinations. AAPT does not consider that there have been material changes in the state of competition in the market since 1999 which would now justify a reversal of the Parliament's clear intent at that time.

Second, as noted above, the Australian Government in 1998 signed the Fourth Protocol to the GATS, which commits Australia to maintaining an effective access regime in respect of certain telecommunication services. In the Protocol, Australia committed itself to establish a non-discriminatory interconnection regime, with recourse to an independent arbitrator in case of disputes. These interconnection rights included the right of a new entrant to interconnect with a 'major supplier' at any technically feasible point in the network.[22] The Australian Government meets its commitments under the Fourth Protocol in part by maintaining Part XIC of the TPA.

Finally, AAPT notes that almost every industrialised country which has deregulated its telecommunications sector has implemented a telecommunications-specific access regime. The obvious exception to this rule, New Zealand, is now moving to implement such a regime. As in Australia, the recent history of telecommunications regulation in industrialised countries has been to strengthen and improve the access regime, rather than to diminish or repeal it.

What are the rationales for the differing criteria for declarations under Part IIIA of the TPA, compared to the telecommunications-specific provisions in XIC? Should the criteria converge, and if so, which part of the Act should be amended?

Stated at its most simple, the difference between the criteria relating to declaration of services under Part IIIA and Part XIC is that the former allows declaration of services of "national significance", whereas Part XIC allows declaration in the LTIE.

The LTIE test encompasses three aspects, which are relevant to the unusual characteristics of telecommunications services, namely:

- the promotion of competition;
- the achievement of any-to-any connectivity;
- encouraging the efficient use of, and investment in, infrastructure.

[22] Fourth Protocol to the GATS, April 1997 *Reference Paper*, Definitions, clauses 1and 2. The Protocol also commits the Australian Government to implementing an effective competitive safeguards regime.

Although there are other industries in which competition and efficient investment are relevant criteria, telecommunications is unusual in requiring the provision of any-to-any connectivity. Accordingly, any amendment to the declaration provisions must include reference to this characteristic.

The promotion (as opposed to protection) of competition is justified in relation to telecommunications because of the move from an industry dominated by a statutory monopolist to one in which services competitors are increasingly significant. It is likely that, at some stage, this transition will be completed and there will be less requirement to declare access services on the basis of a need to promote competition. However, in AAPT's view, it would be premature to remove this criterion from the declaration test in relation to telecommunication services because there is extensive evidence that Telstra and, in some markets, other carriers retain significant market power.

A procedural difference between Parts IIIA and XIC is that the former places declaration in the hands of the relevant minister, following a recommendation from the National Competition Council, whereas the latter gives declaration power to the ACCC. AAPT believes that the lack of political intervention involved in Part XIC declarations is a desirable feature that further warrants the Part's retention.

As discussed below, AAPT's view is that the encouragement of economically efficient investment is largely determined by the setting of prices for access, rather than the fact of declaration itself. It may be, therefore, that this criterion could be removed from the declaration test but retained in relation to the considerations the ACCC must take into account in setting access prices.

> ***Is government regulation of telecommunications access necessary? To what extent can access issues be resolved through commercial negotiations? What is the appropriate role for industry representative bodies such as the Telecommunications Access Forum in determining access codes?***

AAPT is firmly of the view that regulation of telecommunications access remains necessary. There has been considerable use of the declaration and arbitration powers under Part XIC and this regulatory activity has clearly provided the basis for the development of competition in downstream markets. However, the results have not been uniform and, particularly in regard to developing services (such as the unconditioned local loop), regulation of access remains essential.

The importance of access and reasonable terms of access is well recognised. Not only does access on reasonable terms and conditions allow for the *promotion* of competition but it is also a basic element of any policy designed to *prevent* anti-competitive conduct. The ability of a vertically integrated access provider to deny access will allow it to engage in strategic conduct such as imposing "price-squeezes" on competitors and delaying access to downstream markets.

Although AAPT is aware that a significant number of access agreements have been concluded by commercial negotiation, AAPT notes that many of these agreements

have been entered into by smaller CSPs which have no effective bargaining power and limited ability to sustain an arbitration. In addition, where such a party is aware that a larger carrier or CSP has commenced an arbitration, there is even less incentive to commence one's own proceedings, as there is the possibility that more satisfactory terms and conditions may flow through from the arbitrations into commercial agreements.

In AAPT's experience, many access services are provided only reluctantly and rarely, if ever, are they offered at cost-based prices. Commercial negotiation is not necessarily successful in obtaining timely access to these services. The combination of market power and vertical integration, which characterises the suppliers of these services, removes the incentive for them to negotiate access on reasonable terms and conditions which would apply in a competitive market. Even where the industry collectively negotiates terms and conditions (such as in the TAF) the outcomes are rarely similar to those which one would expect to find in a market for the supply of access services where such supply was fully competitive.

In AAPT's view, while the TAF may be a useful advisory body, because of the conflicting interests of its members, it has generally been unable to resolve access issues (including fairly simple propositions such as whether to declare a service). Although the TAF did develop a Telecommunications Access Code which has been accepted by the ACCC, no access provider has yet made use of the TAF Code by submitting access undertakings under section 152BW. Further comments on the role of self-regulation are provided below.

As already stated, AAPT notes the Australian Government's commitment to maintain an effective access regime, under the Fourth Protocol to the GATS. This protocol required the Australian Government to make certain specific commitments as to how it would safeguard and promote competition, and ensure interconnection and access to essential facilities on fair and reasonable terms. AAPT would argue that this amounts to at least an in-principle, if not a binding, obligation on the part of the Australian Government to effective access regulation.[23]

How are the boundaries of telecommunications markets defined when assessing whether to declare a service? Which segments (functional, technological or geographical) of the market require access regulation?

The definition of markets is of secondary importance in deciding whether to declare a service. The focus of Part XIC is on the promotion of the LTIE. Among the three factors which the ACCC can examine in deciding whether the LTIE will be promoted are whether declaration would promote competition in a market for carriage services.

[23] Fourth Protocol to the General Agreement on Trade in Services, signed at Geneva on 15 April 1997, binding on Australia from 8 December 1998 These provisions are found in the 'Schedule of Specific Commitments' agreed to by Australia. Available on internet at Austllii Treaties Library: http://www.austlii.edu.au/au/other/dfat/treaties/1998/9.html

As discussed in the sections on market definition under Part XIB, the ACCC has generally used traditional approaches in defining markets in which the services are, or will be, provided. There has been nothing on market definition in the various reports on declaration to which AAPT would object. However, as noted previously, it may be more important that the Commission consider strategic factors in defining telecommunications markets.

With respect to the 'segment' of the market which requires access regulation, AAPT would regard this as part of the general market definition question. It is not possible to pre-empt which segment requires access regulation. In any case, functional, technological or geographical markets (or a combination of them) could be relevant.

> ***To what extent is it likely that technological and market developments — such as growing mobile and optical fibre networks — will reduce (or increase) the need for access declarations?***
>
> ***What is the process for 'undeclaring' services and is it adequate?***

AAPT has addressed the first of these issues above in its comments on convergence.

The current process for undeclaring services is the same as that for declaring services which, as stated in section 152AO, is a general principle of Australian law. AAPT considers the process appropriate even though to date no undeclarations have occurred. AAPT has recently supported the undeclaration of certain transmission services and believes the current process offers a reasonable opportunity for interested parties to raise concerns and can see no reason for departing from the general practice.

> ***What are the main benefits and costs of access regulations (including any assessment of their dollar values)?***
>
> ***What impacts are the current arrangements having on the industry?***

AAPT is commissioning further research on the economic impact of access arrangements, on which it will comment in later submissions. However, in this initial submission AAPT wishes to make a number of key points.

One of the most important impacts of the access regime, in AAPT's view has been the encouragement of efficient investment in the Australian telecommunications sector. Contrary to the assertions of some incumbent carriers, the existence of an access regime in no way undermines efficient investment, rather it protects and promotes the efficiency of installed infrastructure, while allowing new entrants to build businesses which support further investment.

In AAPT's own experience, access regulation has been essential to providing it and other CSPs the ability to enter and compete in new markets, such as the retail market for local call services. Even where carriers and CSPs have not had to resort to arbitrations, the existence of the access regime (particularly the SAOs) has meant that access providers will generally be under some pressure to provide access. In the

absence of such a regime, there is simply no incentive for such carriers to provide access.

Have the 1999 changes to the legislation been effective? Are any additional amendments warranted, and if so, what form should they take?

In relation to Part XIC, the most significant changes introduced in 1999 were new powers for the ACCC to:

- issue interim determinations in arbitrations (section 152CPA);
- give procedural directions in relation to negotiations (sections 152BBA and 152CT); and
- backdate final determinations (section 152DNA).

The ACCC has made use of the interim determinations power to achieve outcomes which would not have been possible without the legislative changes. These interim determinations have also allowed commercial negotiations to proceed on the basis of the ACCC's expressed views in those determinations.

A positive feature of interim determinations is that they do not impose substantial commercial risks on the access-provider, because the final determination can be backdated. The risk to the regulator is also lower, in that an interim determination is not subject to review. This is to be expected given that interim determinations were designed to provide quick and effective redress during arbitrations, with the safeguard that the final determination could be backdated.

AAPT notes that the Parliament's clear intention in providing the interim determinations power was to simplify and expedite the process of resolving determinations and hence there is opportunity for the ACCC to make more extensive use of this power.

The power to issue procedural negotiation directions has not, to AAPT's knowledge, been used by the ACCC. In AAPT's experience, negotiations with access providers are often delayed or frustrated by the access provider refusing to negotiate in good faith, particularly in relation to the provision of information to the access seeker.

A particular problem for access seekers is that access providers will often delay negotiations by engaging in administrative processes which would not be followed in commercial negotiations where the parties both have commercial interests. Individual instances of such conduct may not be significant enough to give rise to a contravention of the competition rule or notification of an arbitration but, when considered in the context of other competitive disadvantages, can create uncertainty and make competitive entry to new markets difficult. AAPT considers that many access arbitrations could be avoided if the ACCC were to make more extensive use of its powers to direct access providers to negotiate reasonably and transparently.

In regard to backdating final determinations, the ACCC is yet to issue a final determination in an arbitration so it is difficult to comment on the effectiveness of this power.

AAPT considers that the current powers contained in Part XIC are sufficient to allow the to effectively deal with the disputes. However, AAPT has some concerns that the dual role of the ACCC as arbitrator and regulator has, in practice caused some delay in the determination of arbitrations.

In particular, the ACCC has sometimes delayed the making of an interim determination until it has assessed a relevant access undertaking (such as the Telstra PSTN undertaking). While AAPT acknowledges that there will often be similar issues raised in both contexts, and therefore similar enquiries are required to resolve the issues, Parliament clearly did not intend that individual arbitrations should be delayed pending the outcome of an assessment of an access undertaking. The ACCC's approach is potentially problematic in that it signals to access providers that a means by which access on reasonable terms can be delayed is by submitting an access undertaking which is unlikely to be acceptable to the ACCC. The Commission may wish to consider recommendations to clarify the separation between the two processes.

What pricing models are appropriate for examining access pricing? Does the ACCC use the right conceptual approach when examining pricing issues? How can forward looking costs be appropriately calculated? How confident can the ACCC be about the accuracy and applicability of cost estimates underlying any pricing model? How is uncertainty over costs best resolved? How should overhead costs that are common to all services be included in access prices?

What access pricing models are used by overseas regulators and what have been their advantages and disadvantages?

To what extent could existing access pricing approaches lead to over or under-investment in infrastructure or to inefficient entry?

What are the advantages and disadvantages of allowing an 'access holiday' for a carrier installing new risky technologies? (Such holidays would involve a period of guaranteed immunity from declaration.)

How does the access deficit affect the appropriate choice of access pricing model?

To what extent does the potential desirability of price discrimination in some parts of the market (to cover lumpy investments) affect optimal access pricing?

To what extent can and do access pricing models allow peak pricing during congested periods and off-peak pricing when there is substantial excess capacity?

In general, AAPT considers that the choice of pricing model is a matter which is properly left to regulation and relevant decision-makers in individual cases, rather than being the subject of legislation itself. As has become clear since the introduction of the access regime in 1997, the development of pricing models and the economic debate surrounding those is a matter of great complexity and is extremely time-consuming. AAPT would therefore discourage the Commission from engaging in an examination of different pricing models and pricing issues, as suggested by the issues paper.

However, AAPT notes and endorses the intended restriction on pricing principles included in the legislation, which is that pricing approaches based on efficient component pricing rules ("**ECPR**") are generally not appropriate. The Explanatory Memorandum to the Bill suggested that "consequential" lost profits in downstream or upstream markets should not be recoverable through access prices.[24] The ACCC has

[24] Trade Practices Amendment (Telecommunications) Bill 1996, Explanatory Memorandum (p. 44) "…'direct' costs of providing access are intended to preclude arguments that the provider should be reimbursed by the third party seeking access for consequential costs which the provider may incur as a result of increased competition in an upstream or downstream market."

also commented that it will only be in exceptional circumstances that an ECPR approach will be appropriate.[25]

In most circumstances the appropriate pricing model is the TSLRIC model currently used by the ACCC. AAPT considers that the only departure from this model should be made where it is likely to result in costs above a retail cost, such as where a retail price cap is imposed by other regulations. AAPT considers that the access deficit, to the extent that it exists, should not be recovered through access charges, because access services generally do not contribute to that deficit. An alternative mechanism, which is more efficient than that currently used, should be found to recover any such access deficit.

If the Commission considers that detailed consideration of pricing models is required as part of the Review, AAPT submits that this will be an extensive and additional piece of work that would replicate investigations already made by the ACCC. AAPT would need to make a more substantial submission on the relevant issues were the Commission to take this path.

Are there issues of access other than pricing that have emerged as important (such as interconnection delays, forcing access seekers to buy bundles of services, some of which they do not want, and service quality)?

The most important issue other than access, has been delay in the resolution of arbitrations and the provision of access at cost-based prices. AAPT acknowledges that the possibility for backdating final determinations exists and therefore that any access charges in excess of a reasonable access price may be refunded. However, at best this provides only the possibility of financial compensation. It does not remove the uncertainty resulting from delays, which impede the ability of access seekers and providers to plan their investments and operations.

Non-price terms and conditions are increasingly significant, particularly in relation to services which extend beyond simple interconnection. For example, AAPT has had concerns for some time about the standard of provisioning services it receives from Telstra, as well as some customer support services. As competitive carriers and CSPs seek access to services which are closer to the customer (such as the ULL/xDSL services), these issues are likely to become more widespread.

Similarly, AAPT has encountered instances of service levels which are markedly lower than those which Telstra provides its own downstream operations or retail customers.

[25] ACCC, *Access Pricing Principles*, September 1999 pp. 18-9.

The regulatory agencies

> ***Is the division of responsibilities between the two organisations appropriate? Is there any significant duplication and overlap of responsibilities or services? Could the division of responsibilities be improved?***
>
> ***Are there inconsistencies in the regulations, their objectives or implementation, between the two organisations?***
>
> ***Is there adequate co-ordination between the two principal regulatory bodies?***

The division of responsibility between the ACA and ACCC is simply described as the ACA regulates technical regulation and the ACCC regulates competition. This division is clearly appropriate. However, there have been many instances in the development of the regulatory framework where the separation of responsibilities between the two agencies has contributed to delay.

The matters that are subject to some joint action are all subsequently discussed in this submission. Generally the area of duplication and/or overlap occurs when the decision on a competition matter requires some technical advice or is given effect by a technical decision (number portability). The difficulty that emerges is that the decision is handled as a sequential process wherein first one agency, then the other, takes action. This could be removed by creating the responsibility in only one agency, but this would necessitate one gaining expertise in the field of the other.

In essence AAPT does not oppose the division of responsibility. The delays that have been experienced in reaching decisions on some matters are in relation to matters that are unlikely to be reconsidered much in the future. At the staff and board levels the two agencies have developed an effective working relationship and there appears to be no reason for any change.

The role of industry

> ***Do these co-regulatory arrangements affect competition in the telecommunications industry? And if there are any adverse effects, how are these best addressed?***

AAPT believes that the co-regulatory environment in Australia has had no noticeably adverse effects on competition in the telecommunications industry, other than causing delay in some instances.

The ACIF is a forum for a wide range of industry participants to discuss and decide upon technical, consumer protection and other issues. There is a potential, at least theoretically, for competitors in fora such as the ACIF to collude to raise barriers to entry to the market, or to refuse supplies to rivals, but these have not occurred in practice. Given the presence of an effective competition regulator, the ACCC, this is unlikely to occur.

The main difficulty with the co-regulatory process has been the delay experienced in drafting a range of codes, particularly in the areas of inter-carrier operations and consumer protection. These delays in operations codes impact directly on the ability of smaller carriers to compete and to seek redress against carriers which act anti-competitively.

In the drafting of technical codes, the ACIF has usually been reasonably prompt. However, there has been a potential for one or more parties to delay the preparation or signing of Codes. Given that Codes must be approved by consensus, a major participant's objections has the capacity to obstruct the code-making process.

AAPT notes that the TA includes powers for the ACA to request the making of a code[26] within a specified time and to make an "industry standard" where such a request has not been complied with.[27] However, to date the ACA has not used either power.

Are there other roles currently performed by the ACA or the ACCC with a bearing on competition that would be better achieved through self-regulation?

In relation to competition, AAPT considers it vital that regulators continue to have the authority and the ability to oversee the competitive process and intervene where one firm or a number of firms are acting anti-competitively. Self-regulation cannot achieve these ends because one or more of the firms involved in self-regulation could have an incentive to delay or prevent action being taken by a self-regulatory forum.

Self-regulation works most effectively where the participants have similar interests (or at least interests which do not conflict) and none has an incentive to obstruct the self-regulatory process. AAPT would also add that self-regulation is most appropriate where any negative consequences from individual breaches of self-regulatory codes and standards are unlikely to have a dramatic effect on competition.

Anti-competitive behaviour strikes at the operation of a market as a whole; it does not usually have an isolated impact. AAPT would oppose both the transfer of general competition regulation from regulators to self-regulatory and co-regulatory bodies and the dilution of current competition safeguards. AAPT notes that Oftel holds the view that formal regulation is most appropriate where there are players with market power who control facilities that others need to use to compete fairly and there is a need for investigation into, and possible action against, anti-competitive practices by players with market power.[28]

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[26] Section 118.

[27] Section 123.

[28] OFTEL, *Encouraging Self and Co-regulation in Telecoms to benefit Consumers*, June 2000. Available at www.oftel.gov.uk/about/self0600.htm., para S3. OFTEL also notes that the development of technical and operation standards may be more suited to co-operation among industry players, as they are best placed to understand technological issues.

Licence conditions in the Telecommunications Act 1997 under reference

Industry development plans (Part 2)

> ***What are the costs and benefits of the requirement to develop and gain approval for an industry development plan?***
>
> ***What impact has the requirement to have an industry development plan had on entry into, and investment in, the telecommunications industry? Has it resulted in investment or activity that would otherwise not have occurred?***
>
> ***Should the requirement to have an industry development plan continue?***

The cost of the IDP requirement varies from carrier to carrier. AAPT lodged an initial four year plan when applying for its carrier licence in 1997. This plan is reviewed annually and a new plan will be required in 2001. The direct financial costs are limited.

The IDP process unfortunately emphasises upstream industry development, particularly in software or equipment manufacture. It fails to recognise that the activities of competing carriers are themselves a form of industry development. More significantly the developments undertaken within companies that create a competitive marketplace have potentially greater economic impact than encouragement of software or manufacturing industries would have.

AAPT has not found the IDP requirement to have any impact on investment other than the direct cost of having to develop the plan.

Access to supplementary facilities (Part 3)

> ***What are the advantages and disadvantages of making access provision a licence condition when a telecommunications-specific access regime has been established under Part XIC of the TPA?***

AAPT considers it appropriate that access to facilities obtained with regulatory assistance should be made available to other carriers.

With regard to enforceability, the key problem is that licence conditions can only be effectively enforced by the ACA or ACCC. Access to facilities is likely to be an issue of great significance to individual carriers, but may not be a priority issue for regulators. Accordingly, AAPT suggests that it may be more appropriate to incorporate the requirement to grant access into a regime similar to the services regime in Part XIC of the TPA. Further relevant comments are provided below in relation to access to towers and underground facilities.

Access to network information (Part 4)

> ***Why is legislation necessary?***
>
> ***What have been the costs and benefits of requiring this information to be provided?***

The legislation requires carriers which supply carriage services to other carriers to provide information about their network. The access provider is in an inherently more powerful position than the access seeker because the former will have information not ordinarily available to the latter. This would enable the access provider to take advantage of that position in order to damage access seekers. In addition, a service can only be properly offered when the access seeker understands important technical and other data about the service. Information in databases, such as customer location details, would be essential for access seekers to be able to provide an adequate service to their customers.

AAPT fully supports the legislative requirements that mandate the disclosure of network information. AAPT knows from experience that it (and other small entrants) would be severely disadvantaged in their ability to supply customers if Telstra or Optus was able to withhold vital network information. For example, AAPT has found it difficult to obtain exchange boundary information from Telstra during commercial negotiations.

AAPT doubts that the costs to access providers of providing wholesale customers with network information are significant, and would regard claims to the contrary with scepticism. AAPT realises that some costs would be incurred by access providers, but believes that these can be, and are, recovered through the price levied by the access provider. The benefits to AAPT (and, we assume, other carriers) are that they can provide a prompt and adequate service to their customers. The absence of legislative requirements for disclosure of network data would potentially be serious for end-users, because their options in obtaining services provided by non-incumbents (particularly where those services are re-sold services) would be curtailed.

Access to transmission towers and underground facilities (Part 5).

> ***Why is this licence condition necessary when a telecommunications-specific access regime has been established under Part XIC of the Trade Practices Act 1974?***
>
> ***What has been the impact on investment and activity of mandating an access regime in this area?***

The important difference between the access regime in Part XIC of the TPA and the facilities access regime in Schedule 1 of the TA, is that the former deals with access to services, whereas the latter concerns access to facilities themselves. However, with appropriate amendments, it may be possible to include both aspects within a single access regime. AAPT would not oppose the transfer of the facilities access regime to

Part XIC of the TPA, which may allow for more effective enforcement of these requirements, with a transitional provision deeming the declaration of access to towers and underground facilities.

Although there has been significantly less regulatory action in relation to the facilities access regime, it is likely to become increasingly significant as smaller carriers begin to roll out their own networks.

The central difficulties with the regime are the complexity of the processes required to obtain access and the consequent delays. The processes and "safety net" terms set out in the Facilities Access Code are intended to promote competitive negotiation and to provide faster access to facilities. However, in practice, the processes provide opportunities for access providers to delay access.

Other elements of the Telecommunications Act 1997

With respect to each of these provisions, is the allocation of roles and responsibilities between the two key regulators appropriate?

How significant are exemptions to number portability and pre-selection? Are the criteria used to provide exemptions appropriate?

The allocation of responsibility between the ACCC and the ACA in regard to pre-selection, number portability and technical standards for interconnection, is slightly different. Overall, AAPT considers the allocation of roles and responsibilities appropriate. There are, however, some inconsistencies.

The first is in relation to pre-selection where the ACA is required to consult with the ACCC prior to making a determination, but is not required to consult in relation to an application for an exemption. While exemptions are assessed on practical feasibility and cost grounds, these need to be balanced against the interests of end users, which is typically an ACCC function.

The second inconsistency is the inadequacy of the ACCC's arbitration powers in relation to number portability. The TA only allows for arbitration between a first party who has an obligation to provide portability and the other party being the service provider involved in receiving "ports". In practice, every carrier and service provider can be involved in disputes in relation to porting and the ACCC does not have the power to arbitrate in relation to any other than the gaining and losing party. Other service providers required to route calls may not agree with these parties about the method for routing those calls but there is no arbitration available to resolve issues.

Exemptions in relation to pre-selection are potentially very important. They can effectively be used by a provider to attempt to lock customers into an upstream market (typically a local loop provider locking in long distance traffic). The issue is less important where the local loop provider is an alternative access provider. They

are particularly important where the provider is the dominant local loop provider. The criteria used are appropriate, but like all such criteria require some interpretation. Clearly anything is feasible at a cost. The exemption criteria needs to be related back to the benefits foregone from an exemption. As this becomes an LTIE type test the ACA should be required to consult the ACCC prior to granting an exemption.

Exemptions in relation to number portability have similar characteristics. An exemption based on a specific technology class can act to increase a customer's switching cost. The LTIE test is brought to bear as is the requirement to consult with the ACA. The process of applying for an exemption can in itself introduce delays into the introduction of porting, but a regulatory regime devoid of any such potential is impossible to construct.

Pre-selection in favour of carriage service providers (Part 17).

Are the processes and procedures established under this part of the Act appropriate?

What have been the costs and benefits of pre-selection generally?

What are the additional costs and benefits of the requirement that end-users be able to use over-ride dial codes to choose a different provider on a call by call basis?

What are the costs and benefits of the requirement that pre-selection be provided as a single basket? How do they compare to the likely costs and benefits of multi-basket pre-selection?

Has pre-selection been effective in increasing competitive pressures in telecommunications services? If so, how?

AAPT has commissioned some research into the current state of competition and how the regulatory regime has been effective in promoting competition, which includes reference to preselection. AAPT will provide a response to these questions after that research is available.

How aware are consumers of the availability of pre-selection and how does consumer awareness affect the level of competition?

AAPT does not have any current relevant market research on this matter. AAPT would encourage the Productivity Commission to conduct some primary research on this and other consumer issues raised in the paper.

What are the longer run challenges for the relevance and feasibility of pre-selection?

Pre-selection was initially developed as a means of promoting competition in the long distance market as the industry moved from being a monopoly dominated by a vertically-integrated incumbent.

As with other provisions of the regime, until competition is fully effective in countering the anti-competitive effects of vertical integration and incumbency, pre-selection remains relevant.

In a hypothetically competitive, non-integrated industry, there would be two sets of firms, each operating in separate markets. As customers of a local access firms would need to be a customer of a long distance firm who would be accessed via the local access network, local access firms would compete for customers by developing good packages for making choices about long distance providers. This would see the local access firms introducing whatever pre-selection options, including multi-basket arrangements, end user customer demand warranted.

Unfortunately there is a long way to go before there is a fully competitive local access market. In addition, where competition is developing it is from competing integrated firms. Consequently, there is little room for rapid deregulation of the principle pre-selection requirement.

However, the ongoing uncertainty about whether the regulations might require multi-basket pre-selection introduces a disincentive to innovation. A provider who introduces a competing access service and is keen to also carry national long distance may decide to offer an international calls only pre-selection service. This provider would be unlikely to do so as the current regime requires full single basket and may require multi-basket. There would be benefit in deciding for some period the multi-basket issue.

Technical standards about the interconnection of facilities (Div 5, Part 21)

> ***Is there a need for regulations enabling government to set standards about the interconnection of facilities?***
>
> ***Should the consideration of the long term interests of end users and ACCC involvement remain as an explicit part of the standard making process? Or would Part 6 processes be more appropriate? Or any other process?***
>
> ***If the ACCC was to direct the ACA to make a standard under Division 5 of Part 21, is the current standard making process effective, transparent and accountable?***
>
> ***To what extent do existing and planned industry developed codes and standards touch on the interconnection of facilities?***
>
> ***To the extent that industry developed codes and standard do specify requirements about the interconnection of facilities, are these requirements well specified? Have they arisen from a genuine need? Are they performance based (specifying outcomes or performance requirements) or prescriptive (specifying inputs or particular technologies)?***

Current interconnection standards have been developed in the industry self-regulatory process. These are an Australian version of the ISUP Interconnect protocol contained in ACIF:G500.

The provision for the ACA to establish technical standards for interconnection is an essential requirement for the ACCC to exercise its powers of arbitration under Part XIC. Were it not possible for the ACA to set these standards then it might be impossible for the ACCC to reach a conclusion in an arbitration. As the requirement to set technical standards only exists to support the ACCC's other powers it is appropriate that the test for development of standards mirrors the test (the LTIE) for declaration and facilitating access.

While the self-regulatory regime has thus far operated well, the industry will shortly be confronted by the need to review these standards. There are two principal alternative paths. The first is to update the existing circuit switched based regime to the latest global standards, known as ISUP 2000. The other alternative is to move straight to developing interconnection standards for a packet, or Voice over IP ("VoIP"), environment. These issues are currently being discussed in industry forums. It is conceivable that large players may wish to move early to VoIP standards and not upgrade the circuit switched standards. This could result in carriers relying on old standard circuit switched interconnection not being able to offer some advanced services.

The provisions, while untested, appear to adequately provide for appropriate regulatory action to support intervention based on Part XIC by the ACCC.

Number portability (Part 22)

Are the processes and procedures established under this part of the Act appropriate and have they been applied successfully?

Has local number portability been successfully implemented?

Before answering the specific questions in relation to number portability it is again instructive to consider how the telecommunications industry would do certain things if at its inception there were multiple operators in one market and the network functionality was available to route calls correctly to numbers associated on any network. The short answer is that number portability would be a feature of the core network standards.

This is already seen in the way the Internet has developed with its dual addressing standards. The IP number is allocated to the underlying physical infrastructure, the connected machine, while domain names are associated with IP numbers in a set of reference databases. An owner of a domain name can relocate their service to any other machine at any time.

The processes in the TA for the introduction of number portability are designed to ensure that the introduction of what is really the natural state for numbering occurs in such a way as not to be a cost end to users. While the regime is written requiring a positive affirmation of the long-term interests of end-users in the introduction of portability, there is an extent to which the obvious benefit is not disputed, it is more whether the cost of getting there is greater than the benefit.

The introduction of Local Number Portability was partially pre-empted prior to the implementation of the TA with a specific licence condition being placed on Telstra with respect to porting to Optus. Both Global Inbound Service portability and Mobile Number portability have been subject to more direct assessment.

In relation to Local Number portability, this has been successfully implemented to the extent that a number of providers are providing portability to each other. The volume of porting has not been extensive due to a range of factors, not least of which is simple prudent caution. However, the Telstra exemptions for Macrolink ISDN services did delay some significant parts of the market. It is anticipated that porting volumes will steadily increase but it will be some time before porting becomes a customer expectation.

Global Inbound Services (1300,1800) portability implementation has been bedevilled by a number of procedural issues. Current expectations are that implementation in November 2000 should proceed smoothly.

Mobile Number portability was a far more difficult question. Ultimately the ACCC had difficulty in concluding a definitive LTIE test as the ACCC could not adequately assess the costs as there was no specific solution in mind. The carriers were not particularly forthcoming on solutions as they were not prepared to commit the resources to evaluating options if they did not have an obligation. Consequently, the ACCC moved later on declaring portability than was probably warranted, but the time

taken in the decision making cannot be recovered in the implementation. MNP is now scheduled for September 2001.

> ***Has the introduction of local number portability been successful in increasing competitive pressures in telecommunications services? If so, how?***
>
> ***What have been the costs and benefits to consumers and industry of number portability for the different market segments?***

AAPT will answer these questions in a later submission that addresses the development of competition overall.

> ***How aware are consumers of the availability of number portability and how does consumer awareness affect the level of competition?***

AAPT is not aware of any available empirical research into the level of consumer awareness of number portability and its impact on competition. The UK regulator, Oftel, has conducted some research on the point (available at: http://www.oftel.gov.uk/cmu/research/choice00.htm). AAPT encourages the Commission to undertake its own research in this regard.

> ***What provisions, if any, should be made for number portability for other services?***
>
> ***Will the pricing principles for number portability outlined by the ACCC promote competition in the market for telecommunications services and/or encourage economically efficient use of, and investment in, telecommunications infrastructure?***

AAPT believes that any new service should be introduced with number portability provisions. However, as there are a number of uses of numbers to carrier specific services the existing review process is the appropriate test.

AAPT does not consider that the current provisions which allow the ACCC to set pricing principles require amendment. The particular principles applied by the ACCC are outside the scope of this Review.

> ***Will there be other areas of telecommunications services, such as some e-mail services, where portability will become an important future issue?***

Portability is clearly a feature of telecommunications services which consumers value. The ability to change providers without changing local telephone or fax numbers is convenient and saves money for consumers.

E-mail addresses have some characteristics which are different from telephone and fax numbers. The domain name, in particular, is distinctive, and usually identifies a

particular ISP, company or other organisation which hosts the user's e-mail address. The ability to change hosts without changing one's e-mail address could be a benefit to consumers.

Division 3 of Part 22 of the TA allows the ACCC to direct the ACA to declare a person a 'declared manager of electronic addressing'. The ACA may direct a 'declared manager of electronic addressing' to do, or refrain from doing, a particular act or thing relating to the carriage service. The ACCC can make similar directions if the electronic addressing is of public importance and compliance with the direction is likely to have a bearing on competition.

This Division appears to give the ACA and/or the ACCC the power to make rules with regard to electronic addressing where competition is at stake, but this is not free from doubt.

AAPT suggests an amendment to the legislation which would clarify that the ACCC has the power to mandate electronic address portability (eg. for e-mail addresses). The ACCC could then decide, in consultation with the ACA, whether in fact such portability should be mandated. AAPT is not saying that electronic address portability is necessarily required, but rather that the *potential* for it to be mandated by law would be an advisable step.

Numbering plan

The Commission invites views on the effect on competition of the ACA's numbering plan (including its operational rules).

The Numbering Plan, outside of the portability provisions, has only marginal impact on competition. The Plan could be relevant if it were administered in such a way as to create barriers to entry by the artificial restriction of access to numbers, or by creating an ability for one provider to allocate "better" numbers than another.

The ACA has already commenced studies to address the need to ensure an adequate supply of numbers. One of the potential issues is the continued block allocation of numbers. This results in every provider in city areas being allocated 10,000 numbers where they may need only a handful. This inefficiency will eventually be addressed by moving to a pooled approach to number allocation.

Number pooling will be a sensible approach once the extent of porting results in network efficiency being gained by undertaking Intelligent Network look-ups for all calls. It is generally accepted that this point occurs somewhere before 30% of numbers are no longer on their home network. This in turn will require significant further development of competing access networks. However, the declaration of the Unconditioned Local Loop service will see more service level competition combined with number portability.

There appears to be no need to change the legislative provisions of the operation of the Numbering Plan.

2.3.3 Other matters

The impact of other regulation

> ***What impact do other regulations have on competition and the effectiveness of telecommunication-specific competition regulation?***
>
> ***What regulations outside of telecommunications have impacts on telecommunications competition?***

In AAPT's view, there is a virtually unlimited number of other regulations which affect competition in the telecommunications industry. However, AAPT submits that these will only be relevant to the Review to the extent that they interact and affect the operation of the provisions nominated in the Terms of Reference.

AAPT does not consider that is any need for the Commission to consider other provisions in the context of the Review.

Information requirements

> ***In assessing the impact and appropriateness of telecommunications-specific competition regulations, the Commission is also seeking some broader information about the industry. In particular:***
>
> - ***the responsiveness of consumer demand to changes in prices of various telecommunications products;***
> - ***the costs of providing key telecommunications products in different markets (and how these may change over time); and***
> - ***any studies or analysis which may provide useful insights into competition regulation in the telecommunications industry, including quantitative assessments of the costs and benefits.***

In regard to the Commission's first information request, AAPT is not aware of recent Australian empirical studies of demand elasticities. In this regard, it may be necessary for the Commission to conduct or commission its own research.

Other than the general observations contained in other parts of this submission, AAPT cannot include costing data in this public submission. However, it would be prepared to consider requests from the Commission for more detailed cost information in relation to particular telecommunications product on a confidential basis.

AAPT is conducting two research projects relevant to the Review. The first focuses on the development of competition in Australian telecommunications markets and the impact that competition has had on telecommunications prices and the non-price

aspects of competition. The second study analyses the impact of the regime on investment in Australian telecommunications markets. AAPT will make comments based on the results of these studies in later submissions.

Lessons from other industries and other countries

What lessons can Australia learn from the experience of other countries that have attempted to regulate private telecommunications markets and move away from government owned monopoly providers?

What do the experiences of New Zealand suggest about the advantages and disadvantages of generic competition policy? In particular:

- ***what has happened to total factor productivity, prices and service quality in New Zealand compared to Australia since the adoption of a generic competition regime? How much of these differences can be ascribed to competition policy and how much to other factors? And***
- ***what is the relevance of the Telecom-Clear dispute?***

Most countries with deregulated telecommunications sectors have adopted industry-specific regulation to ensure that the change from monopoly supply to competitive supply is successful. The form of this regulation varies from one regime to another but access arrangements are a key issue in these considerations.

AAPT notes that to date New Zealand has been somewhat of an exception to the general rule, although even in New Zealand a level of industry-specific regulation has existed. AAPT notes that few countries have chosen to follow the New Zealand model. Indeed the Government there is currently conducting a review of telecommunications legislation, and the draft report from the Inquiry panel strongly favours a move toward industry-specific regulation with striking similarities to the Australian model.

Are there areas where incentive regulation (as used partly in US telecommunications) have applicability in Australia?

The central provision of the US Telecommunications Act 1996 in which incentive regulation is used is section 151, which allows Bell operating companies to supply certain long distance services only if they satisfy a "competitive checklist". The checklist includes requirements relating to the provision of non-discriminatory interconnection and related services.

Incentive regulation has had some effect in the US because of the "line of business restrictions" which were imposed on the regional Bell operating companies in the Modified Final Judgment in the *US v AT&T* case. The lack of any significant market

constraint on Telstra's fields of operation would make it difficult to base incentive regulation on the same approach.

Nevertheless, it may be possible to apply similar ideas through regulatory presumptions which effectively reverse the onus of proof where Telstra (or other carrier) has information which is generally not available to the regulator or competitors. For example, in relation to the pricing of access services, if a number of benchmarks were available to the regulator, it would be reasonable to presume the lowest approximates the cost of the service. Such a presumption could reasonably be made because the carrier itself is likely to have access to the most detailed information which would allow the true cost to be determined, once that data is verified.

It may also be possible to use a limited form of incentive regulation in the context of proposed mergers or joint ventures involving carriers with market power.

AAPT supports the Commission exploring incentive regulation and would welcome the opportunity to comment on specific proposals during the course of the Review.

> ***What international evidence is there about the beneficial (or adverse) impacts of telecommunications competition policy on consumers?***
>
> ***What lessons can be learned from the operation of access regimes in other industries? In what ways is a distinctive approach to telecommunications justified?***

Competition in the telecommunications industries of other countries has yielded positive results. In all countries in which competition has commenced, prices for most services have fallen considerably, a greater range of services has been introduced, and the quality of these services has improved. Consumer welfare – the over-riding objective of competition policy – has been greatly enhanced wherever competition has been introduced.

AAPT points to the UK experience as an endorsement of many aspects of the Australian telecommunications regime, and as a guide to what should be avoided or improved in regulation.

The UK has a wide range of carriers, as well as numerous 'indirect operators', in competition with BT in fixed, mobile and other markets. The choices available to most UK consumers are vastly greater than they were even a few years ago. Still, competition and its benefits do not always seem to be evident to consumers. A recent OFTEL study has shown that a significant proportion of consumers in the UK are unaware of the availability of carriers other than the incumbent, or that better services may be obtained from other carriers.[29] While many consumers would be satisfied with BT, it appears that many consumers remain either uninformed about better

[29] OFTEL, *Consumer Awareness and the Use of Competition in the Residential Fixed Line Market*, May 2000. Available at www.oftel.gov.uk/cmu/research

alternative services or are reluctant to change carrier for a variety of reasons. Apparently switching costs and inertia influence the decision of many UK consumers.

The UK has also seen major price decreases over the years for a range of services, such as international and long-distance calls. Price decreases have been less pronounced in the local call market, largely because of a lack of local loop unbundling.

The UK market has been deregulated for much longer than the Australian market – over fifteen years – but the UK experience suggests that the Australian approach is generally sound in promoting consumer welfare. In some ways, Australia adopted a less interventionist approach – licence conditions are seldom used here as a regulatory tool as they are in the UK. On the other hand, the Australian regime adopted a sophisticated access and dispute-resolution procedure (Part XIC) which the UK has lacked. The UK is also only now applying general competition laws to the telecommunications sector, which Australia has done since 1997. The Australian approach has generally been successful. In a short time, compared with the UK market, prices have fallen and carriers and their services have diversified and improved in Australia.

AAPT would point to these trends, and the recent UK and New Zealand move to subject the telecommunications market to wide-ranging competition law, as a general confirmation of Australian telecommunications-specific competition regulation.

3. CONCLUSIONS AND FURTHER INQUIRIES

AAPT believes that the current telecommunications-specific competition regulation has been vital in protecting competition, ensuring efficient investment and promoting the welfare of telecommunications end-users. AAPT strongly supports the retention of Parts XIB and XIC of the TPA and those parts of the TA which relate to competition.

Neither the recent history of the Australian telecommunications industry nor likely future developments over the short to medium term provide any justifications for repeal of Part XIB, XIC or the competition-related provisions of the TA. On the contrary, the continuous development of new services which rely on upstream services and the danger of existing market power being extended into these new areas demands the retention of all the current elements of the regime.

Conclusions on elements of the regime

Part XIB of the TPA

Part XIB has been important as both a preventive measure and a cure to anti-competitive conduct. Part XIB has resulted in Competition Notices and litigation being pursued by the ACCC in instances of clear anti-competitive conduct. The ACCC's role in safeguarding competition has been greatly enhanced by Part XIB, because it provides rules and remedies that are not available under Part IV of the TPA.

Moreover, AAPT's experience strongly suggests that Part XIB has been a significant deterrent to anti-competitive conduct that may have occurred if that Part had not been introduced. The lower threshold of proof, the serious pecuniary penalties, and other measures have undoubtedly had an effect of decreasing the likelihood of anti-competitive conduct by those carriers with market power.

The information-gathering powers under sections 155, 151BK and 151BU are important regulatory tools. They give the ACCC essential powers to obtain information from carriers relevant to its functions of preventing anti-competitive conduct. AAPT does not consider reform to these provisions is required, although it does believe that the ACCC should be more assertive in using these powers to promote and protect competition.

Part XIC of the TPA

Part XIC has been a successful and important part of the development of competition in Australian telecommunications markets. It has enabled the opening of many telecommunications markets to true competition by ensuring that new entrants have an adequate footing to compete with incumbents, while also providing proper safeguards to the legitimate interests of incumbents.

AAPT considers that the current LTIE test reflects an appropriate balance between the interests of access seekers and access providers. The benefits to end-users flowing from Part XIC have been tangible and plentiful with the most striking example being PSTN access and the flow through effects to national and international long distance services.

Part XIC has also been important in producing a dispute-resolution regime that avoids the rigidity and cost of litigation and gives carriers a more structured forum for resolving disputes. Here too, AAPT's only significant concern is that the ACCC has not been as assertive enough in its use of the extensive powers Parliament provided in the legislation, particularly those powers provided as part of the 1999 Amendments.

For the above reasons, AAPT strongly supports the retention, in full, of the current Part XIC provisions.

Telecommunications Act 1997

AAPT believes that the TA has generally been beneficial to competition in the telecommunications industry. The TA's rules on number portability, pre-selection and technical standards have all been positive for end-users, and have fostered conduct by carriers that they may have otherwise been slow to engage in. AAPT supports the retention of these provisions of the TA.

On the other hand, AAPT believes that some other aspects of the TA have proved to be unnecessary or even counter-productive to competition. In particular, AAPT believes that the industry development plans required by Part 2 of Schedule 1 of the TA, while perhaps desirable before 1997, are now unnecessary and impose unjustified compliance and other burdens on carriers.

AAPT's overall views

Competition is yet to broaden and deepen

Competition in the telecommunications industry cannot be regarded as a homogenous whole. As discussed in relation to regional markets, the penetration of competition, both in terms of scale and scope, should be regarded as occurring in stages, as competitive carriers build the experience and customer bases which allow them to deliver new services in new markets.

The effects of the current regime have been felt most dramatically in market segments with high concentration: primarily business services and long distance voice services. These gains have been the result of the combination of regulatory policy and investment incentives. AAPT believes that the existing telecommunications regime must be preserved in order to ensure that all Australians benefit from strong and effective competition.

Access-based competition leads to infrastructure-based competition

An argument is often made by incumbent carriers that access (services) based competition and facilities-based competition are contradictory and that a competition regime which allows access to infrastructure will stifle investment.

The development of competition in telecommunications markets shows the opposite is true. In those markets where access services have promoted competition, investment opportunities are created. In AAPT's view, the most efficient way to secure facilities-based competition is to allow new entrants to build a customer base using access services. This provides the incentive for investment, the means of securing funding and the experience to efficiently employ those funds in new networks.

The administrative cost of the regime is less than alternatives and is more fairly distributed

The costs are shared fairly because all carriers are required to contribute on the basis of revenue. This should be extended to CSPs and the loopholes closed. The alternative (less regulation, more litigation) means that those who suffer the most and are driven to court action and have to pay the costs of protecting their rights. Developing an accurate assessment of the costs is complex and AAPT is conducting further studies and will be the subject of further submissions.

The competition protections need to be made stronger not weaker

It is clear that carriers which possess market power have adapted to the advent of competition by seeking to protect the markets in which they dominate and to leverage this power into related markets (such as Internet access and content). In order to deal with these issues, the Commission should consider new mechanisms to control the extension of power into evolving markets.

Further inquiries

As outlined above AAPT believes the core issue for the Review is the extent to which the current regulatory regime, in Part XIB, Part XIC and certain provisions of the TA, meets the Government's policy objectives. In that regard the key issues are the development of competition and efficient investment in infrastructure.

AAPT has commissioned economic studies in relation to each of these aspects (see Annexures B and C) and intends to address issues arising out of these in its supplementary submission.

AAPT strongly supports the current industry-specific legislative regime and, except where it specifically says otherwise, urges the retention of this regulation. There are still many segments of the Australian telecommunications market which are not subject to true competition, with the result that not all consumers have shared equally in the benefits of telecommunications reform. Australia is not ready in the foreseeable

future for the repeal, whether partial or total, of telecommunications-specific competition regulation. Strong competition regulation remains important in promoting the interests of Australian consumers and contributing to the nation's long-term economic growth.

List of Abbreviations

AAPT	AAPT Ltd
ACA	Australian Communications Authority
ACCC	Australian Competition and Consumer Commission
ACIF	Australian Communications Industry Forum Ltd
AOTC	Australian Overseas Telecommunications Commission
Austel	Australian Telecommunications Authority (superseded by ACA and ACCC)
B2B	Business-to-Business (internet transactions)
CAN	Customer Access Network
COA/CAM	Chart of Accounts / Cost Allocation Manual
Commission	Productivity Commission
CSP	Carriage Service Provider
DDAS	Digital Data Access Service
EC	European Commission
ECPR	Efficient Component Pricing Rule
FCC	Federal Communications Commission (United States)
Fourth Protocol	Fourth Protocol to the General Agreement on Trade in Services
FTC	Federal Trade Commission (United States)
GATS	General Agreement on Trade in Services
GBE	Government Business Enterprise
GSM	Global System for Mobile communications
HFC	Hybrid Fibre Coaxial Cable
IP	Internet Protocol
ISDN	Integrated Services Digital Network

LMDS	Local Multipoint Distribution System
LTIE	Long-term interests of end-users (specified in section 152AB of TPA)
OFTEL	Office of Telecommunications (United Kingdom)
Optus	Cable and Wireless Optus Ltd
OTC	Overseas Telecommunications Commission (predecessor of Telstra)
PSTN	Public Switched Telephone Network
TA	*Telecommunications Act* 1997
TA 1991	*Telecommunications Act* 1991
TAF	Telecommunications Access Forum
Telecom Australia	Predecessor of Telstra
Telstra	Telstra Corporation Ltd
TIO	Telecommunications Industry Ombudsman Ltd
TPA	*Trade Practices Act* 1974
TSLRIC	Total Service Long Run Incremental Cost

Competition Research Project

Frontier Economics has been commissioned to conduct a research project into the development of competition in Australian telecommunicatoins markets since 1997.

The Competition Research Project will focus on the state of competition in the provision of a range of telecommunications services including local services, national long-distance, international long-distance, fixed to mobile services, mobile services, internet services and data services.

State of Competition

To achieve the objectives of the study it is necessary to obtain data to describe the state of competition at the commencement of the regime in 1997 and the state of competition today. Although it is not possible to directly measure the state of competition, a range of market data can used to infer the state of competition. These include market shares, the number of competitors and the likelihood of further entry.

It is possible to obtain market share data for a number of the services detailed above including local services, national and international long-distance and mobile services. It appears it will be more difficult to obtain the required data for internet and data services.

Outcomes for Consumers

The aim of promoting competition under Part XIC is to promote the long-term interest of end-users. The promotion of competition is included as an element of the LTIE, because it is likely to lower the prices of telecommunications services, increasing service quality and increasing the range of services available.

To demonstrate a link between changes in the state of competition since 1997 and outcomes for consumers, it is necessary to identify changes in prices, service quality and the range of services available to consumers under the new regulatory regime. A number of agencies have conducted studies of price changes, including the ACCC, the Productivity Commission and the OECD. These studies are based on the prices of the incumbent (Telstra) and do not adequately incorporate the discounts available to consumers through pricing plans. As a result, they may not capture the full extent of any price decreases.

Evidence of price and quality changes can be included in the study for some of the services, but they are unlikely to fully reflect the benefits to consumers under the new regulatory regime.

Recent work by the Productivity Commission

The Productivity Commission has been analysing the state of competition in telecommunications markets and measuring outcomes for consumers for some time. The

Productivity Commission's most recent publication *International Benchmarking of Telecommunications Prices and Price Changes*, December 1999 details their most recent analysis and thinking.

AAPT does not wish to replicate work the Productivity Commission has done or will do as part of the current Inquiry. To ensure that this does not occur AAPT and Frontier wish to discuss the Competition Research Project with the Productivity Commission at an early stage.

Investment Research Project

Access Economics has been commissioned to conduct a research project which will assess the impact of the telecommunications-specific competition regime on investment in telecommunications infrastructure in Australia.

Access and pricing

The Investment Resarch Project will describe the economic rationale for providing access to and related pricing issues in terms of investment. An assessment will be made of the impact of the access regime on the level of investment and the qualitative aspects of investment (extent of duplication, use of new technology).

Level of investment

To achieve the objectives of the study it is necessary to obtain data which allows inferences to be drawn about the level of investment which would exist with and without the competition regime. In addition to Access' own series, ABS data would be relied upon to give a picture of investment in Australia before and after the introduction of the 1997 regime. It may also be necessary to obtain data from carriers themselves.

To demonstrate a link between changes in the level of investment since 1997 and changes in the telecommunications-specific competition regime, it may necessary to compare the Australian experience with that in other developed countries, both those which have, and those which have not, deregulated their telecommunications industries.

Another means of assessing the impact of the regime on investment outcomes is to compare investment in infrastrutcure used principally to supply services which have been declared under Part XIC of the TPA and in relation to services which have not been declared.