TELSTRA CORPORATION LIMITED

Submission to the

Productivity Commission Inquiry into Telecommunications Specific Competition Regulation

9th August 2000

Executive Summary

Telstra welcomes this opportunity to put its views to the Productivity Commission Inquiry into Telecommunications Specific Competition Regulation.

Telstra's view is that the current telecommunications market in Australia is extremely competitive at all levels, has an established presence by many of the world's major telecommunications providers and appears certain to remain so. In these circumstances, whatever the virtues or criticisms of Part XIB of the Trade Practices Act in the past, the undeniably fierce competitive market means there is no role for Part XIB in the future. This is particularly so, in view of the heavy administrative burden the regime places on the industry; and the disincentives the regime generates in relation to innovation and competitive investment.

Telstra acknowledges the need to maintain an access regime to ensure competitive access to bottleneck services, either through the retention of Part XIC, or some other regime. However a clearer line needs to be drawn between largely essential services and services in markets that should be treated like markets in other parts of the economy. Greater certainty and investment confidence needs to be generated in relation to those services which continue to be regulated.

In relation to investment, it is clear that Australia suffers from very skewed patterns of investment in the fixed network as a result of regulatory distortions. The access regime and the access pricing principles that are already embedded within it, generate enormous costs and deter efficient investment. As a result, it is already apparent that there is no significant fixed network investment by Telstra's competitors outside the major metropolitan regions. This pattern of investment cannot continue if the Government wishes to improve service quality and data capability in rural Australia.

To be successful, and having particular regard to Australian regulatory conditions, a telecommunications regulated access regime needs to:

i) restore incentives to resolve disputes without recourse to arbitration;

ii) allow self-regulatory processes to continue to mature. (ACIF has in Telstra's view been the outstanding success story of access regulation in Australia and its processes are being studied by regulators from the UK to Singapore);

iii) deal with service providers competing in the same downstream markets on an even-handed basis; and

iv) restore incentives to invest where investment is desperately lacking.

This submission is divided into four sections.

Section 1 examines the state of competition in Australian telecommunications and finds that Telstra faces well-placed, robust, competitors in all the market segments where regulation has not prevented competition from developing. Like Telstra, most of these competitors are extensively vertically and horizontally integrated; many are affiliates of corporate entities far larger than Telstra itself, and draw on the resources of these entities in competing in the Australian market. Optus has now had near on a decade to move out of "infant competitor" status, including a six year period in which it was specially advantaged; it is surely difficult to believe that this kind of asymmetric treatment should be perpetuated indefinitely. Telstra believes that claims that continued "infant competitor" protection is required are unsustainable.

The case for moving away from the current, highly intrusive, arrangements is made all the stronger when account is taken of the costs these arrangements impose. The provision of regulated access on uneconomic terms has dulled the incentives for facilities-based competition, virtually eliminating investment by Telstra's competitors outside of the CBDs. At the same time, it makes Telstra's continued investment in the core network ever more marginal – thus threatening the long-term sustainability of the Australian telecommunications industry.

Moreover, the over-reach of the regulatory regime – with ever more services being brought within the regulatory net – and the 1999 amendments have dramatically over-loaded the regulatory machinery. Telstra estimates that 18 access disputes were lodged in the 23-month period between July 1997 and May 1999. In contrast, in the 14-month period between June 1999 (when the amendments came into effect) and August 2000, the number of new arbitrations lodged exploded to 25. One important implication of this upsurge is that the resources of the ACCC have been stretched, with the result that arbitrations have become ever more extended. Of all the arbitrations lodged to date, only 1 (one) has so far reached the final determination stage; and of the 25 active arbitrations, 10 have been going for 12 months or longer. This is, Telstra submits, a regulatory mechanism that is simply not working.

Continuing with these arrangements will merely perpetuate the excessive burden currently being imposed on market participants - most notably Telstra – not only in terms of the resources consumed by the regulatory process, but most importantly in terms of distortions of competition and of resource allocation. The fact that telecommunications is one of the potentially fastest growing parts of the Australian economy; that the ACCC, unlike its counterparts elsewhere, has sought to regulate not only the more mature parts of the industry but also those where technological developments are most pronounced; and that the resulting regulatory errors could severely handicap Australia's growth prospects, make a move away from these arrangements all the more urgent and important.

Section 2 reviews in detail Part XIB of the Trade Practices Act 1974 ("**the Act**"). In Telstra's view, these industry specific laws are not necessary and never were. First, there is no evidence that the issues that arise in telecommunications require industry specific market conduct laws. Second, in Telstra's experience, the industry specific laws have the potential to be costly in terms of regulatory error, without delivering any offsetting benefits in terms of reducing administrative delay or promoting a clearer application of competition rules. Accordingly, and for the detailed reasons provided in this submission, Telstra submits that the Productivity Commission should recommend the repeal of Part XIB.

Part XIB has proved unnecessary. Telstra has not been found by a court to have contravened the "competition rule" established by Part XIB. More relevantly, all of the conduct pursued by the ACCC under Part XIB could have been pursued as effectively and just as quickly under Part IV of the Act, whilst providing greater certainty to industry participants, reducing the risks of costly regulatory error and maintaining appropriate limits on regulatory discretion. It follows that Part IV is both sufficient and preferable to regulate any potentially anti-competitive conduct in the telecommunications industry beyond 2000.

Section 3 reviews the performance of Part XIC of the Act – the access regime. This section finds that in exercising its powers under Part XIC, the Australian Competition and Consumer Commission ("**ACCC**") has focused almost exclusively on promoting short-term competitor gains while ignoring whether its declaration and access pricing decisions will promote efficient investment in infrastructure. This has resulted in a regime that extended well beyond the regulation of essential facilities. In the longer term the access regime, if continued unchecked, has the potential to undermine the short-term benefits that competition has so far delivered to consumers by stifling investment incentives.

The performance of Part XIC of the Act, as applied by the ACCC, is characterised by systematic regulatory overreach. Since the enactment of Part XIC in 1997, the ACCC has dramatically expanded the scope of the regime beyond its original purpose. It has not operated solely as a mechanism for providing regulated access to essential facilities. Rather it has been used by the regulator to engineer market outcomes deemed desirable for the promotion of competitors with little regard to the effects on efficient investment incentives and the potential costs that this regulatory over-reach may impose on the Australian community. Unlike the general declaration process under Part IIIA, Part XIC imposes few constraints on the regulator's discretion. In Telstra's view, this failing of Part XIC urgently requires reform. The effects of the declaration process are further exacerbated by elements of the determination process which have resulted in unsustainably low and inconsistent access charges. The wide reach of the declaration provisions when coupled with the implementation of the determination process has resulted in an extraordinary

number of access arbitrations lodged with the regulator and, more importantly, limited investment in local network infrastructure outside of CBD areas.

Telstra notes the ACCC's proposed solution to the growing number of access arbitrations is to make arbitration decisions public. Telstra strongly disagrees with this proposal. First, it is the role of access undertakings to set generic terms and conditions on which access disputes can be resolved. This process involves the *access provider* submitting access terms and conditions for assessment by the ACCC. In contrast, the ACCC's proposal simply allows the *ACCC* to submit the terms and conditions of access without any means of assessment. In Telstra's view this would provide the ACCC with unreasonable discretion over the setting of access prices. Second, the ACCC's proposal would remove any remaining incentive that access seekers may have to negotiate commercial outcomes.

Section 4 addresses the Productivity Commission's specific questions raised in the Issues Paper relating to this Inquiry.