TELSTRA CORPORATION LIMITED

Public Submission to the

Productivity Commission Inquiry into Telecommunications Specific Competition Regulation

30th 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.

1 Introduction and Overview: Competition and the state of markets

The central feature of today's telecommunications markets is that they are intensely competitive, with vigorous rivalry characterising all the industry segments excepting those where regulatory distortions prevent competition from developing.

This section, which introduces and provides an overview of the main elements of Telstra's Submission, examines the state of competition in Australian telecommunications. It shows that far from competition being still in the infant or fledgling state, Telstra now faces strong, well-established competitors – in many instances, the subsidiaries of entities far larger than Telstra itself. Additionally the evidence shows that where competition has not developed to the same extent – primarily in access and local call service – the main impediment is not inherited market power, but rather persistent regulatory intervention that makes it cheaper and easier for competitors to rely on Telstra's network than to build networks of their own. Given this evidence, it is concluded that whatever the case for industry-specific regulation may have been in the past, that regulation is now largely an obstacle to the efficient development of Australia's telecommunications industry.

The first two parts of this section present essential background to the development of telecommunications markets in Australia, including some elements of their internal dynamics and the impact of the social policy objectives pursued by successive governments. This is followed by a review of the development of competition during the duopoly period and after its end in July 1997. The fourth part of this section then examines the impact that the telecommunications specific regulation has had on infrastructure competition in Australia. The section concludes by considering the lessons and challenges for public policy arising from the current state of Australian telecommunications.

1.1 The industry context

Intense competition, in telecommunications in Australia as elsewhere, primarily reflects industry characteristics that facilitate the entry and rapid expansion of new providers. The main factors at work are rapid growth in telecommunications demand, and the prospect of even stronger growth to come, which greatly reduces the risk entrants bear in committing efficiently sized plant; and continuing technological change in networks and services, which has acted to reduce the absolute capital costs involved in entry, while creating opportunities for entrants to differentiate their products and thereby attract new or poorly served demand. Looking to the future, Telstra expects these factors to persist and intensify, with a proliferation of entry opportunities both in well-established services and in the newer market segments. As a result, Telstra believes (1) that no part of the telecommunications industry can properly be described as a natural monopoly and indeed (2) that any market power Telstra may once have had has been substantially reduced.

While changes in the underlying characteristics of telecommunications are reshaping telecommunications markets worldwide, the development of competition in Australian telecommunications has been significantly affected, and in Telstra's view distorted, by the evolving regulatory regime.

Unlike New Zealand, which from the start of liberalisation removed all regulatory barriers to entry into telecommunications and simply applied general competition law to the sector, Australia has undergone a prolonged transition from the statutory monopolies in place until the early 1990's to full competition. A regime oriented to promoting the growth of competitors, by managing market outcomes to meet entrants' needs, has been at the centre of this prolonged transition. From 1991 to 1997, the primary goal of the regime was to nurture Optus as a full-fledged competing network to

that operated by Telstra. Since 1997, the focus appears to have shifted to a more general objective of promoting Telstra's competitors. Reflecting these changing orientations, the precise form of the regulatory regime, the instruments on which it has relied, and the market outcomes obtained have evolved over the liberalisation process. At present, Parts XIB and XIC of the Act are the legislative instruments that operate primarily to promote Telstra's competitors. Attachment A details the full set of regulatory imposts that bear upon Telstra and to some extent other telecommunications carriers, highlighting the fact that telecommunications is now one of the most regulated industries in Australia.

1.2 The role and impact of social policy objectives

The liberalisation process and its outcomes cannot be understood in isolation from the other telecommunications policy goals being pursued by successive governments. More specifically, while purporting to seek a transition to an essentially unregulated market, governments have continued to impose significant constraints on market outcomes in the name of wider goals of social policy. Obligations to serve at regulated prices are the main instrument on which governments have relied in this respect.

In theory, the move to price cap regulation from administered control of telecommunications pricing through the Prices Surveillance Act and the then Prices Surveillance Authority ("**PSA**") was intended to allow greater flexibility in telecommunications pricing and help achieve a better alignment between prices and costs. In fact, the opposite has occurred, with less price rebalancing being allowed under the successive price caps then had been permitted by the PSA. As a result, the most heavily controlled retail prices have been forced to levels which are well below the long run costs of supply.

While the extent of the distortions has been variously quantified, all the available estimates find large and persistent gaps between prices and costs. Thus, a 1995 study calculated the avoidable cost, stand-alone cost, and attributable revenue from local and STD calls in Australia in 1989. The results of that analysis are shown in Figure 1. That data can be used to show that the access deficit in 1989 was between $1.2 billion and $1.5 billion.[1] In 1997, the then Industry Commission published an updated analysis of the access deficit in its paper "Telecommunications Economics and Policy Issues". Figure 2 shows the assumptions the Industry Commission used in its analysis. The Commission estimated that the annual access deficit at that time was $597 million.

Figure 1: Avoidable and stand-alone costs and attributable revenues 1987/88 ($m)

Service	Local Calls	STD Calls
Avoidable Cost	$1,077	$256
Stand-Alone Cost	$4,091	$3,271
Attributable Revenue	$1,587	$2,269
Avoidable Cost:Attributable Revenue	40%	10%

Source: Table 1, Ergas (1995).

[1] Ergas, Henry. "Prices, Costs and Subsidies in a Telecoms Network – The Australian Experience", Ch.6 in *The Economics of USO*, Analysis Publications, 1995.

Figure 2: Assessment of the access deficit by the Industry Commission

	Residential access	Business access
Annual rental/line	$139.80	$240.00
IC estimated of LRMC	$235.00	$235.00
Number of lines	6,450,000	2,760,000
(Deficit)/surplus ($m)	(614)	14

Source: Industry Commission 1997, *Telecommunications Economics and Policy Issues"*

More recently, the ACCC has estimated that the average line cost in 2000-01 is $346 per line per annum, which results in an access deficit of $1.18 billion for 2000-01, a substantially larger access deficit than that estimated by the Industry Commission[2].

These estimates relate to the gap between regulated rentals on the one hand and the costs involved in providing a subscriber line on the other. More recently, however, an additional distortion has arisen as a result in changes in the use of the local call service. As the number of households accessing the Internet has risen,[3] local calls are increasingly being used as the means by which residential consumers connect their computer to the facilities of an Internet Service Provider ("**ISP**"). Unlike conventional voice calls, which are relatively short,[4] calls to ISP's often last 30 minutes or more. The rising number of these calls has therefore increased the average duration of local calls, rising from approximately 5 minutes in 1997-98 to 7 minutes in 1999-00 and an anticipated mean duration of 8 minutes in 2000-01.

This rise in local call holding times has a number of implications. It imposes additional costs on the network, both as a direct result of the increase in the volume of traffic and of the need to accommodate a more variable and skewed distribution of call lengths.[5] Additionally, taking account of the longer call durations, the fixed and untimed charge for local calls has fallen progressively short of their cost. Thus, if ACCC estimates of the cost of a local call are used, the cost of an eight-minute local call, *excluding retailing costs*, is 22 cents (see Figure 3 below); this compares with a ceiling retail price of 22 cents for such a call. As a result, local calls do not, on average, recover their long term costs of supply.

---

2 A Report on the Assessment of Telstra's Undertaking for the Domestic PSTN Originating and Terminating Access Service, July 2000.

3 Recent estimates suggest that some 20 per cent of Australian households have access to the Internet. See Communications and Information Technology. Special Article - The information society and the information economy in Australia (Year Book Australia, 1999).

4 An average duration of some 4 minutes is conventionally assumed in network dimensioning.

5 Telecommunications networks are dimensioned to provide a specified grade of service, defined in terms of the proportion of call attempts that fail due to network congestion. For any given total volume of traffic, the network capacity required to meet a specified grade of service increases with the variance and skewness of the distribution of call durations.

Figure 3: Local call costs 2000-01

Local call conveyance costs

Network components	TSLRIC[1]	Routing[2]		
		LAS	*Inter-LAS*	*TNS*
IRIM-LAS	0.0149	0.64	0.64	0.64
RSS/RSU-LAS	0.0010	1.28	1.28	1.28
LAS-LAS	0.0019	0	1	0
LAS-TS	0.0007	0	0	2
IRIM	0.0010	0.64	0.64	0.64
RSS/RSU	0.0018	1.28	1.28	1.28
LAS	0.0014	1	2	2
TS	0.0009	0	0	1
Cost per conversation minute		0.0152	0.0185	0.0189
Average local call duration		8 min	8 min	8 min
Cost per local call		0.1213	0.1477	0.1509
Weights for local call routing[2]		8%	46%	46%

Weighted average cost per local call =
Cost per average local call * weights for local call routing = **14.85** cents per call

Access deficit

Based on the ACCC's approach to calculating and allocating the access deficit[1], the access deficit allocated to local calls is **7.26** cents per call (0.45 cents per end-use minute).

Total local call cost = 14.85 cents plus 7.26 cents = **22.11** cents per call

Source:
1 ACCC 2000, A Report on the Assessment of Telstra's Undertaking for the Domestic PSTN Originating and Terminating Access Service, July.
2 NERA 1999, Estimating the Long Run Incremental Cost of PSTN Access, Final Report for the ACCC, January.

The controls on Telstra's charges for rentals and local calls therefore create deficits that, in the absence of public subsidies, need to be financed through higher margins on other services.

Historically, the higher margins needed to recoup these losses have been obtained from the STD and IDD services. Thus, the 1995 estimates referred to above show that the avoidable costs of providing STD service in 1989 amounted to $256 million; STD revenues in that year were $2.2 billion. Equally, the Industry Commission, in the study also referred to above, estimated that the average per-minute charge for STD was 2.5 times average cost, while the average per-minute charge for IDD was 1.5 times average cost.

Telstra accepts that social policy goals are legitimate. However, in Telstra's view, there is no justification for pursuing these goals using the current price controls, which are harmful to economic efficiency. What is important is that in addition to their direct costs in terms of economic efficiency, these price distortions have had two major and inter-related implications for the competitive process. First, they have made the STD and IDD markets very attractive to potential entrants, since these are the markets in which margins have been high. And second, so long as entrants could use the incumbent's local network at charges that did not fully reflect the revenue loss they thereby imposed on the incumbent, they have had little incentive to deploy local

networks of their own, at least outside the most densely populated parts of Australia (see section 1.5 below). It was consequently inevitable that competition would centre on the long-distance markets, with competition in the retailing of access and local calls being essentially a marketing tool in the rivalry to sign up long distance customers.

1.3 The development of competition: the duopoly period

Shaped in part by these continuing price distortions, competitive entry into and expansion in the more lucrative markets has proceeded rapidly in each stage of the liberalisation process.

In the period to 1997, Optus was the main beneficiary of regulatory intervention. For six years, the regime operated to actively favour and promote Optus, both by directly reducing the costs it needed to incur so as to enter and expand, and by constraining Telstra's ability to respond to the emerging competitive processes. The stated goal of these interventions was to allow a transition from a highly managed market towards one reliant on the more general instruments of competition policy. The policy approach was, in other words, of the "infant industry" kind, the theory being that the "infant" would at the end of the specified period, be able to stand on its own feet.

It is worth emphasizing the wide range of instruments, and the intrusive nature of the policies deployed to this end. Thus, through controls over the ability to offer selective discounts, Telstra's capacity to compete with Optus at the retail level was severely curtailed. At the same time, a panoply of measures were used to diminish the costs Optus needed to bear so as to compete in the market.

Legislation granted rights of way to Optus placing it on an equivalent footing with Telstra; Optus also had, by the terms and conditions of Telstra's licence, access to Telstra's ducting, towers and other infrastructure; and most importantly, origination and termination prices and terms and conditions, including the availability and form of over-ride and preselection were regulated on terms highly favourable to Optus. More specifically, interconnection charges were based on a cost standard, known as "Directly Attributable Incremental Cost" (DAIC), which took little account of overhead costs, and more generally of joint and common costs, in the calculation of the cost pool Telstra was allowed to recover. Charges set this way allowed Optus substantial margins relative to the prices Telstra charged for STD and IDD services at that time.

This can be seen from an indicative calculation of the STD margins available to Optus set out in Australian Communications in May 1995, in the context of estimation of the efficient component price (ECP) for access. These estimates, summarised in Figure 4, show that Optus could secure a margin, net of interconnection charges and of the avoidable costs of STD, of $1.29 on the average STD call.

Figure 4: Estimation of Optus margins on 5 minute STD calls

	Cost / price
Standard Telstra tariff	$1.66
DAIC of access	$0.27
Trunk transmission costs	$0.05
Billing costs	$0.05
ECPR access price	$1.56
Access price under interconnection	$0.27

Source: Australian Communications, May 1995

Thus advantaged, Optus made rapid and substantial in-roads, both through over-ride access (in which customers dial an access code to place calls) and through preselection. By September 1996, close to 100 per cent of the population had access to Optus' network, and Optus' brand recognition was high: indeed, as early as April 1993, Optus' sales and marketing director Cleve Whatley is reported as saying "the image-making so far has been extremely successful for Optus, with research showing that 98% of the population recognise the company for the right reasons—as an alternative long distance and mobile carrier with great service and lower (on average) prices."[6] As Optus' brand recognition increased, so too did its market share: Telstra's domestic long-distance market share (as measured in minutes) fell from 100 per cent in 1992 to 88 percent in 1995 and then to 79 percent in July 1997, while Telstra's share of international long-distance traffic fell from 100 per cent in 1992 to some 65 per cent in June 1997.

Telstra's loss of market share was paralleled by a steady increase in customer churn in terms of changing their preselected / preferred long distance carrier. This degree of fickleness on the part of customers means Telstra could not take the loyalty of a very substantial group of customers for granted (whether they were Telstra or Optus subscribers). Rather, Telstra had to take the maintenance and winning of customers very seriously. Further, there is no evidence that Telstra could identify those customers most likely to churn, and treat them better than other customers even where this was legal. As a result, Telstra had to compete for all customers' business to prevent market share loss.

This was reflected in price movements, especially in the more lucrative market segments on which Optus focussed its competitive efforts. By mid-1995, Telstra's IDD prices, taking account of discounts, were no higher than Optus'. As for STD, price differentials had been entirely eliminated by the end of the duopoly period largely through the offering by Telstra of greater rebates in its top-end discount plans. However, despite substantial price equalisation, Optus continued to increase its penetration of the market, reflecting strong non-price competition.

While striking in and of themselves, the gains Optus, as the beneficiary of regulation, made from the start of the duopoly period on are especially great when set in international perspective. Less than two years after Optus had commenced service, the U.K. Sunday Times reported the following comparison of Optus with Mercury, its Cable and Wireless-owned U.K. sister and another new entrant duopolist:

> "Bob Mansfield, Optus chief, says that by the beginning of this month 800,000 [customers] had used its service at least once: 'We have more customers today after 16 months of operation than Mercury has after seven or eight years.'"[7]

By the end of the duopoly period, Telstra's competitors generally, and Optus particularly, had secured market shares that were no less than, and generally substantially greater than, those obtained by entrants in markets, such as the US and the U.K., whose liberalisation had substantially preceded that in Australia. At the same time, extensive competitor capacity was in place, with the substantial duplication of Telstra's access infrastructure in CBDs, the roll-out past over 2 million homes of Optus' HFC and the completion of Optus' inter-capital network.

---

6 Plunkett, S., 'Optus: Building Rome In A Day', *Business Review Weekly*, 2 April 1993, p. 22.

7 'Australia dials C for confusion' in *Sunday Times*, 18 July 1993.

1.4 The development of competition after the end of the duopoly

Despite the extension and consolidation of competition, the end of the duopoly did not mark the end of industry-specific regulation. Rather, the transfer of the main economic regulatory powers to the ACCC was accompanied by the putting in place of far-reaching controls over virtually every aspect of the industry's conduct, which have since been deployed largely to the benefit of Telstra's competitors.

The end of the duopoly removed the constraints on the laying of competing infrastructure, with carrier status being made available on an effectively unrestricted basis. Within 12 months of the end of the fixed network duopoly, 13 additional carriers had been licensed. In addition to these, there was a rapid increase in the number of service providers, with the number registered with the Telecommunications Industry Ombudsman ("**TIO**") [8] rising to 878 by 30 June 1999. Of these, 24 were carriers and 79 were service providers, 760 were Internet service providers (ISPs), and 15 were both service providers and ISPs.[9] At 5 July 2000, there were 44 carriers licensed by the ACA[10].

The strong competitive pressures generated by continuing entry have been reflected in substantial changes in the market behaviour of industry participants. In the period through to late 1998, competition focused on IDD and STD charges, with the spread of price-capped offers (such as $3 and then $2 price-capped STD calls). However, as these marketing innovations were rapidly imitated throughout the market, their effectiveness in attracting customers waned. It was in this context that several of Telstra's competitors began to offer discounted access to local calls to those customers who preselected their STD and IDD services. These moves, which benefited from the greater customer understanding of local call charges (relative to the more complex price structures used for STD and IDD), met with a strong consumer response. At the same time, the ACCC's decisions in first declaring a local call resale service made this competitive strategy increasingly attractive.

The aggressive promotion of these competing offers has been reflected in persistently high levels of consumer churn as customers change carriers. As can be seen from Figure 5, the number of customers churning between competing providers (including Telstra) for their preselected long distance traffic (preselection churn) has increased from around 130,000 a month towards the end of the duopoly period to close to 200,000 a month at the start of this calendar year. Figure 5 depicts churn to and away from Telstra; it thus reveals an increasing tendency for customers to not remain committed to the services offered by a single carrier. Rather, there is a high degree of switching to and away from competing carriers. Telstra expects this trend to continue, perhaps more strongly, as a result of recent initiatives by the company to win back customers from its competitors. Similarly, Figure 6 shows that the total number of commercial churns has increased from approximately 6,000 in early 1998 to 130,000 in early 2000. As a result, the aggregate rate of movement in the customer base has increased very substantially, nearly trebling over a less than three-year period. Such a pattern is direct evidence of the competitive nature of the Australian telecommunications as all carriers seek to win customers from each other. In this regard, Telstra is

---

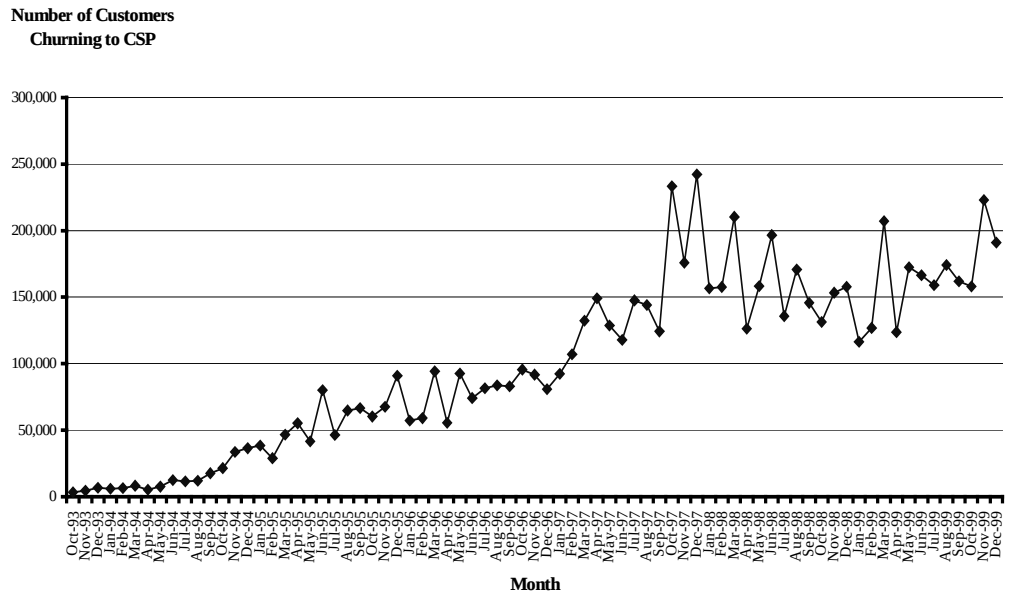
8 The TIO was established at the direction of the Federal Government in 1993 to resolve disputes between telecommunications companies and residential and small business customers. In 1997 the TIO's jurisdiction was extended to include complaints about Internet service providers (ISPs) .The TIO is independent of telecommunications companies, consumer groups and government, and is a free service to consumers. http://www.tio.com.au/index.html

9 Australian Communications Authority, 1999, *Telecommunications Performance Report 1998-1999*, p 3

10 http://www.aca.gov.au/licence/carrier/carriers.htm

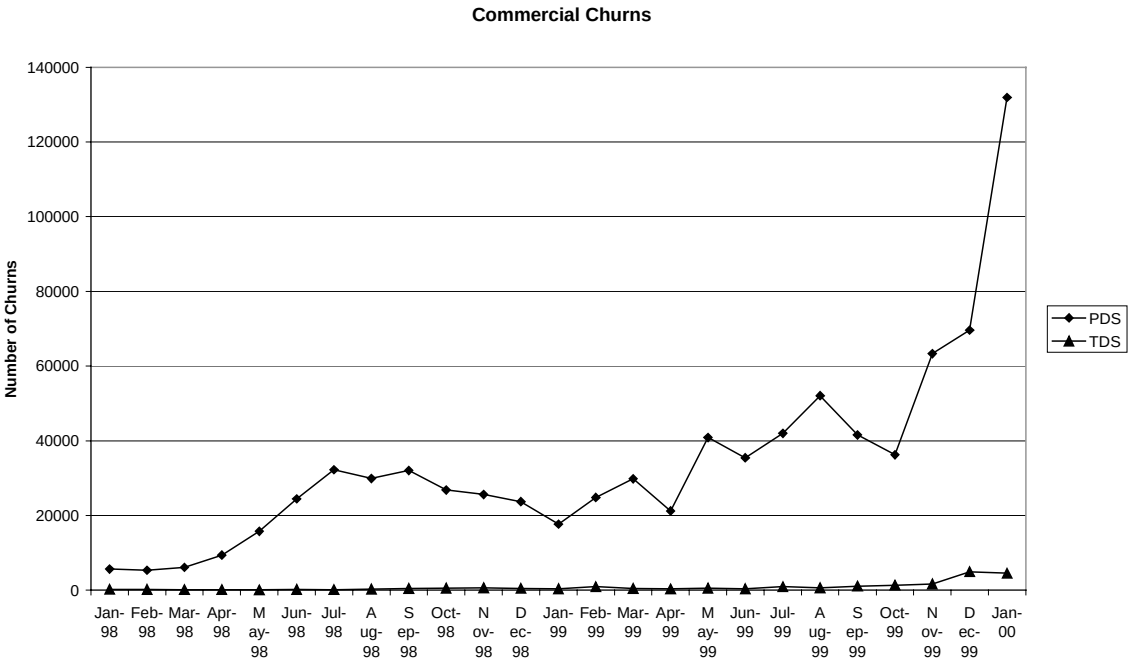
putting significant resources into this competition and is certainly aiming to attract many customers currently with its competitors.

Figure 5: Preselection churn, 1993-1999



Source: Telstra

Figure 6: Commercial Churns



Source : Telstra

While the packaged local/long distance offers have been mainly directed at residential consumers and smaller businesses, competition has been no less intense for larger customers. The top 15 per cent of business customers, ranked by outlays, account for over 90 per cent of business outlays on STD and IDD; they are also by far the largest purchasers of advanced, data-oriented, services, where growth prospects are particularly strong. The fact that these customers are readily identified and targeted, and that they tend to be located in the low cost to serve CBDs of the major metropolitan areas, makes them a natural focus for intense competition.

Indeed, for reasons considered more fully below, it is these customers, and virtually only these customers, who have been the target of significant investment in competing local networks.

Already in 1998, local call services provided by Optus using its CBD local access network in combination with other "Business Network Services" accounted for 13% of Optus' operating revenue for the financial year.[11] In contrast, local telephony, largely supplied by the Optus HFC in non-CBD areas, provided less than 1% of Optus' operating revenue.[12] Since that time, further duplication of CBD networks has occurred, as newer entrants, such as PowerTel, MCI Worldcom, Agile and Davnet have deployed fibre optic rings in the main business centres. At June 2000 Telstra identified at least nine players that had rolled out optic fibre infrastructure in CBD areas to provide telephony, data services and transmission capacity.

Strong competition, both at the consumer and at the corporate end of the market, has been reflected in intense downward pressure on prices.

Thus, Telstra's prices for STD and IDD have fallen dramatically since 1997. For example, Telstra reduced its peak tariff on the UK IDD stream from $1.09 per minute to $0.37[13] per minute over the period from January 1998 to May 1999. Figure 7 shows the reductions in Telstra's IDD tariffs across this period for the largest three IDD streams, the US, New Zealand and the UK. In each case IDD prices have fallen to approximately one third of their January 1998 levels.

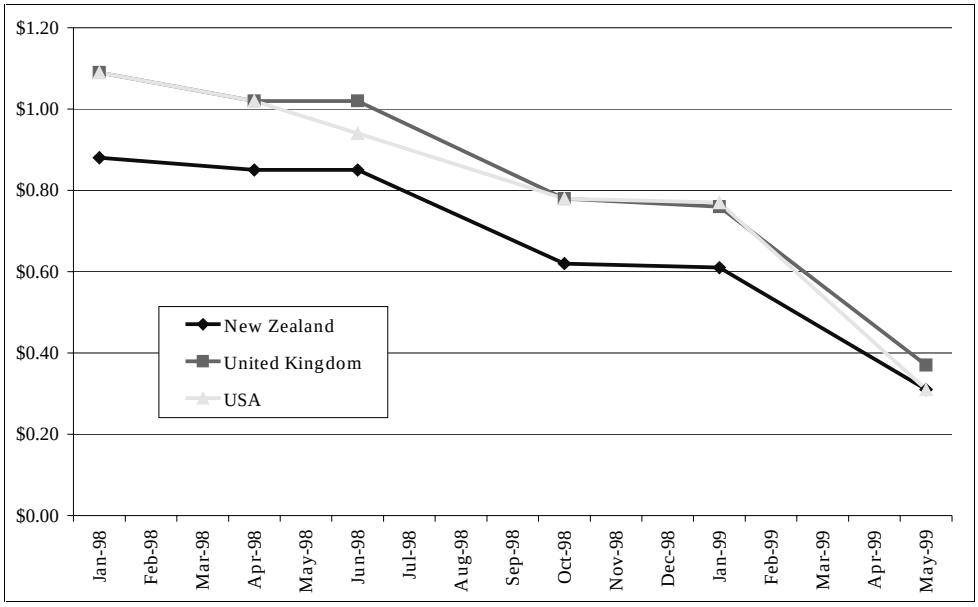
---

11 Cable & Wireless Optus Prospectus, 29 September 1998, p. 42.

12 Cable & Wireless Optus Prospectus, 29 September 1998, p. 38.

13 The January 1998 tariff is based on Telstra's peak tariff under the Smart Saver Flexi-Plan. The May 1999 price is based on Telstra's tariff under the 0011 Easy Minutes tariff. The May 1999 figure includes the $0.15 connection fee as a $0.03/minute addition. Hence, the price presented is for a 5 minute call.

Figure 7: Telstra's day-time tariffs to New Zealand, UK, USA, Jan 1998 to May 1999



Telstra has also reduced its STD tariffs substantially over the same period. Figure 8 shows the standard tariff prices of different duration residential STD calls supplied by Telstra over the period September 1997 through December 1999. The price of a 30-minute off-peak STD call is now less than one third of the price in September 1997

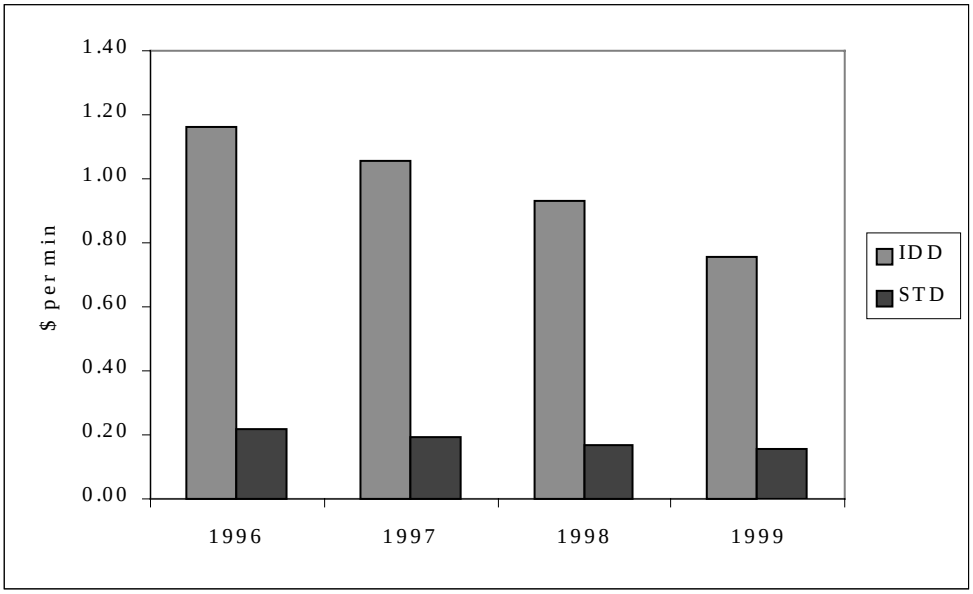
Figure 8: Prices for STD calls supplied by Telstra, Sept 1997 to Dec 1999

Day time residential	30 minute call	10 minute call	5 minute call	3 minute call	1 minute call
Sep-97	$19.37	$6.54	$3.33	$2.04	$0.76
Apr-98	$17.62	$5.95	$3.04	$1.87	$0.70
May-98	$10.65	$3.65	$1.90	$1.20	$0.50
Feb-99	$8.46	$2.92	$1.54	$0.98	$0.43
Dec-99	$7.10	$2.50	$1.35	$0.89	$0.43
Economy residential	30 minute call	10 minute call	5 minute call	3 minute call	1 minute call
Sep-97	$9.74	$3.33	$1.72	$1.08	$0.44
Apr-98	$8.87	$3.04	$1.58	$0.99	$0.41
May-98	$5.40	$1.90	$1.03	$0.68	$0.33
Feb-99	$4.32	$1.54	$0.85	$0.57	$0.29
Dec-99	$3.00	$1.60	$0.90	$0.62	$0.34

Source : Telstra published tariffs for the > 745km distance band

Overall, as can be seen from Figure 9, Telstra's average revenue per minute for both STD and IDD has continued to fall substantially since the end of the duopoly period.

Figure 9: STD and IDD Average Revenue Per Minute, 1996-1999



Source: Telstra

These price falls are large by international standards. A Productivity Commission international benchmarking study[14] of price reductions for standard services shows that price reductions in Australia over the period from February 1998 to June 1999 were in the top three of a group of nine similar countries[15] across four out of five typical service baskets for medium and small businesses, with no country consistently performing better than Australia. Moreover, for the one small business service basket and for the residential service basket in which Australia's price reductions placed it in the middle of the group (fifth), it still recorded an 8% fall in prices over the period. Although international comparisons must be treated with caution, these estimates confirm the strength of the downward pressures on telecommunications charges in Australia, relative to those in similar countries surveyed.

Despite these substantial reductions in prices, Telstra has suffered continuing losses in market share. As a general matter, market share data are not a useful indicator of the competitiveness of a market if that market is characterised by very low barriers to entry or regulation that keeps prices at levels below cost, such as the supply of access and local calls, where the price cap regime constrains prices and the system of quality standards inflates costs. Despite these obvious limitations with market share data, most analyses of competition include some measure of changes in market share and they should be examined, particularly in those segments of the telecommunications industry where price controls do not result in enforced losses.[16]

---

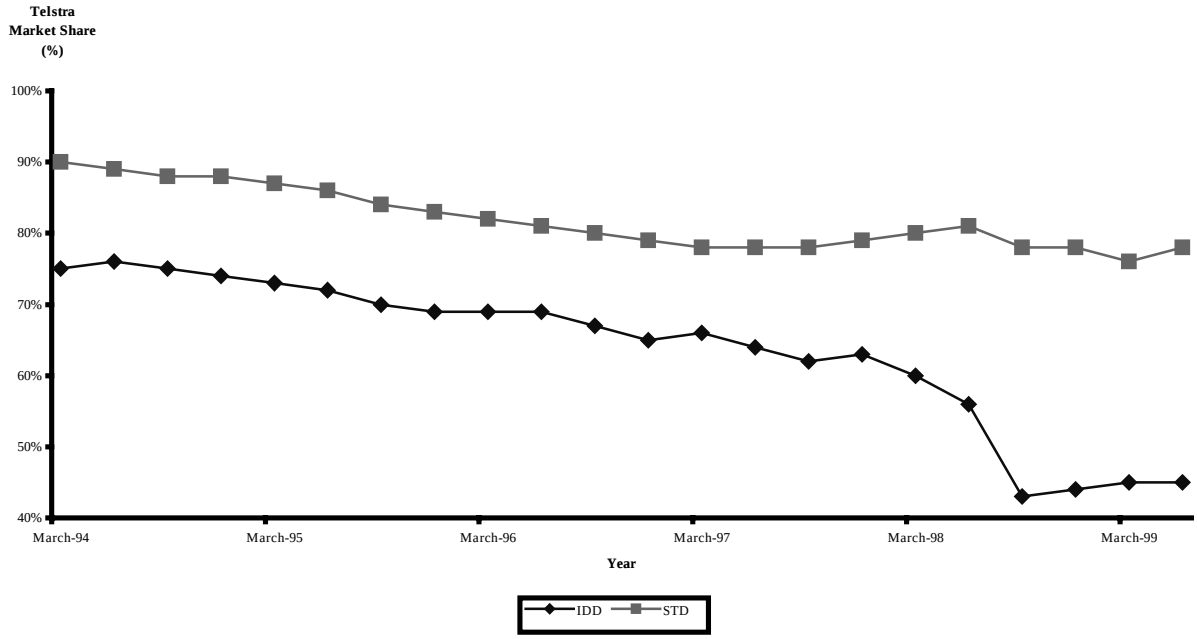
14 Productivity Commission, International Benchmarking of Telecommunications Prices and Price Changes, December 1999

15 The countries in the survey were Sweden, Finland, United States, France, Australia, New Zealand, Canada, Japan, and United Kingdom.

16 The Australian carriers do not publish data that could readily be used to calculate market shares and hence it is necessary to rely upon estimates based upon carrier annual reports and other imprecise secondary data sources that are produced periodically by Paul Budde Communications, Merrill Lynch, and by the ACCC as part of its various inquiry processes.

Telstra's own estimates of its market share in IDD and STD markets over the period March 1994 to 1999 (detailed in Figure 10) show that competitors have eroded Telstra's market share consistently over this period.

Figure 10: Telstra IDD and STD Market Share, March 1994 to March 1999



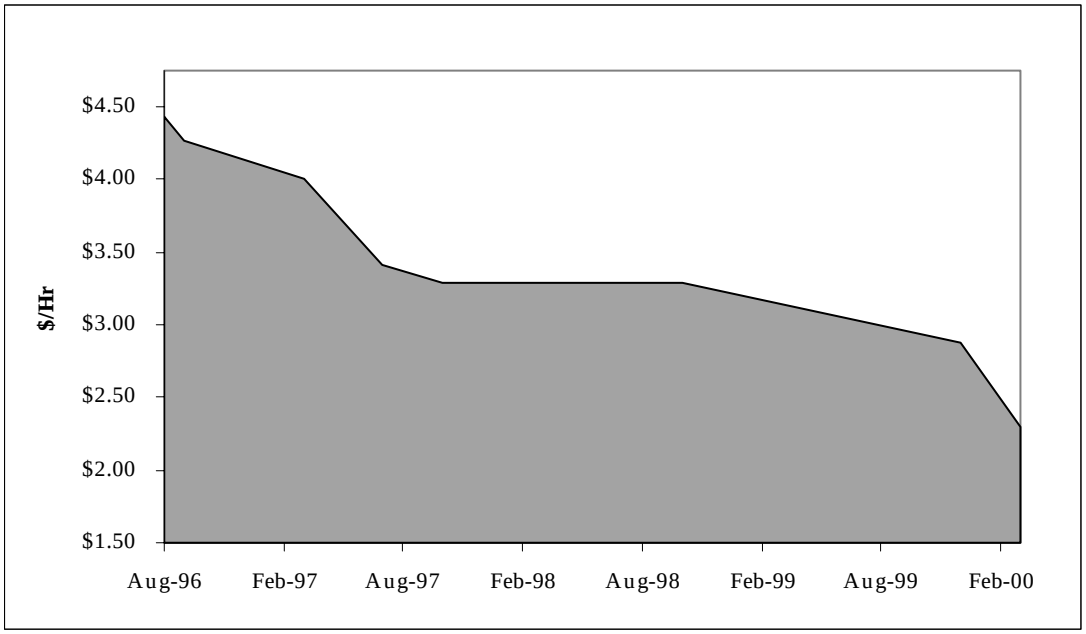
Source: Telstra

Competitive pressures have been even more intense in the newer, faster growing parts of the market, such as the supply of Internet access services. Thus, the number of ISPs in Australia has increased rapidly, going from 308 in October 1996 to about 700 today.[17] These aggregate numbers under-state the extent of gross entry, as they net out firms leaving the activity with those coming into it. New ISP's have found it relatively easy to expand: ISPs other than Telstra, OzEmail, Optus and AOL increased their customer numbers from 360,000 in October 1997 to over 1.1 million in October 1999, corresponding to an annual compound growth rate of output in excess of 75 per cent. With customers being relatively footloose, the competitive pressures on service providers have been very strong.

Figure 11 details Telstra's (Big pond) average retail price trajectory for ISP service from August 1996 to March 2000, with prices more than halving since August 1996.

17 www.consult, *9th IAP Report*, October 1999.

Figure 11:Telstra (Big Pond) average hourly retail price for ISP service 1996-2000



Source: Telstra

1.5 The impact of regulation

While competition has become more widespread and better established, its development has been far from uniform. Specifically, Telstra's competitors have only really offered access and local call services in the CBDs, while relying on regulated access to Telstra's network to provide services elsewhere. They have, in other words, only invested in their own facilities in the most densely populated, high revenue areas, while relying on Telstra to incur the investments needed to provide services in the other parts of Australia.

The evidence to this effect is overwhelming. Local number portability (LNP) information and Telstra's access payments to competitors evidence the proposition that outside of CBD areas competitor local telecommunications infrastructure is extremely limited.[18]

Local number ports provide a good indication of competitor infrastructure because if a competitor successfully wins a customer from Telstra and that customer wishes to retain his, her or its existing number then Telstra is required to port that number to the competitor. Competitors can only terminate ported numbers where they have local infrastructure in place. Figure 12 below presents the cumulative number of services by call charging area (CCA) and identifies those provided by Telstra and those services ported to competitors in 1999-00.[19]. Telstra's data on LNP requests indicates that local network infrastructure is limited to four CCAs – Sydney, Penrith, Melbourne

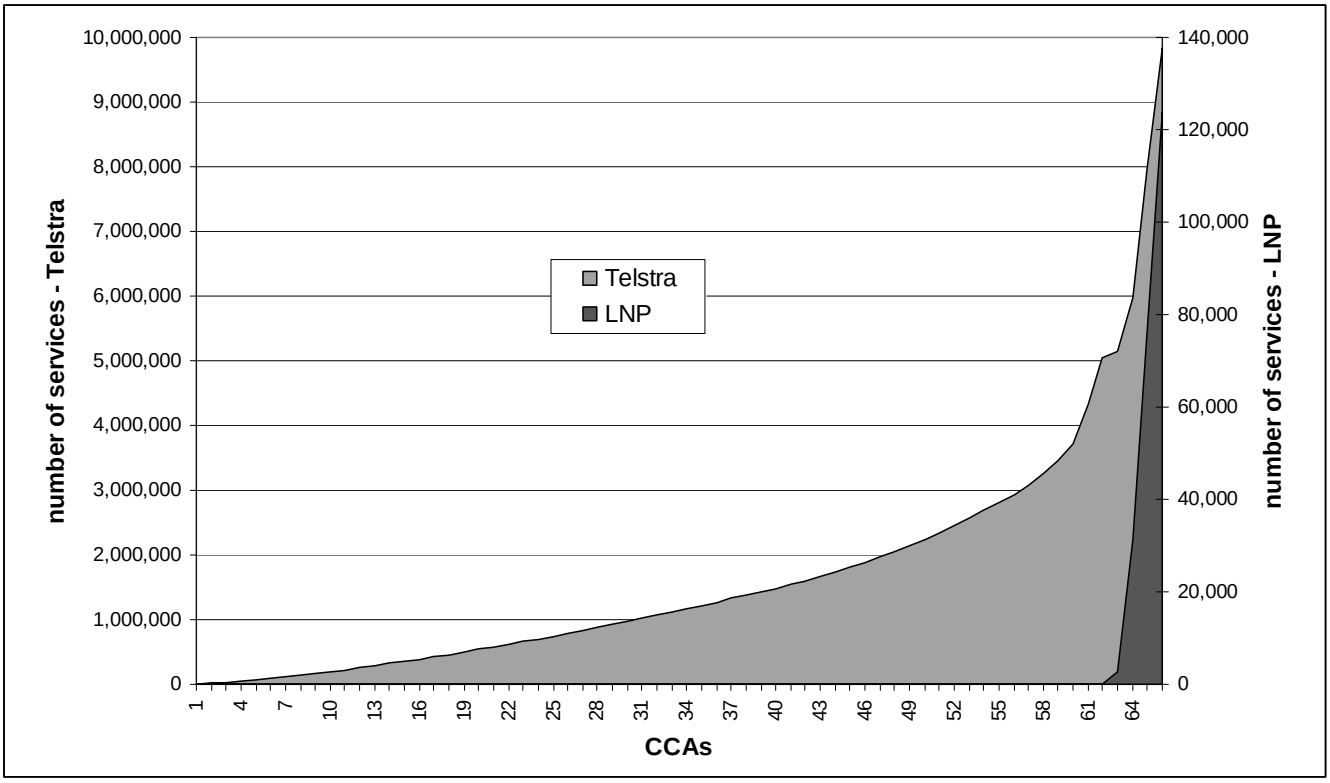
---

[18] Suggestions that competitors have failed to invest in rural and regional Australia because of some advantage that Telstra may have in terms of access to the USO are unsustainable. There are many areas in Australia that are *not* officially net loss areas (i.e. eligible for USO subsidies) where Telstra is the only carrier that has invested. The outer metropolitan areas of the big three cities, the smaller state capitals and the larger regional centres are cases in point. Specifically, Telstra received a subsidy in 1997-98 for 416,616 services. The ACCC estimates that there are 1.2 million rural services and 1.6 million provincial services. To the best of Telstra's knowledge almost none of these services have access to competitor's infrastructure.

[19] Australia is divided into 66 call charging areas (CCAs) for the purposes of interconnection. Telstra records local number ports and access payments by CCA

and Brisbane and the total number of services ported to competitors account for just over 1 percent of total services across Australia. It is important to note that the LNP information is somewhat limited as competitors can directly connect customers to their local network without LNP if that customer is willing to change phone numbers. In this case, Telstra would not record any information for LNP. While this suggests that the LNP information may underestimate the total volume of traffic carried on competitor networks, the geographic distribution of LNP requests still reveals that competitor infrastructure is concentrated in CBD areas.

Figure 12: PSTN Services by CCA - Telstra connections compared with local number ports

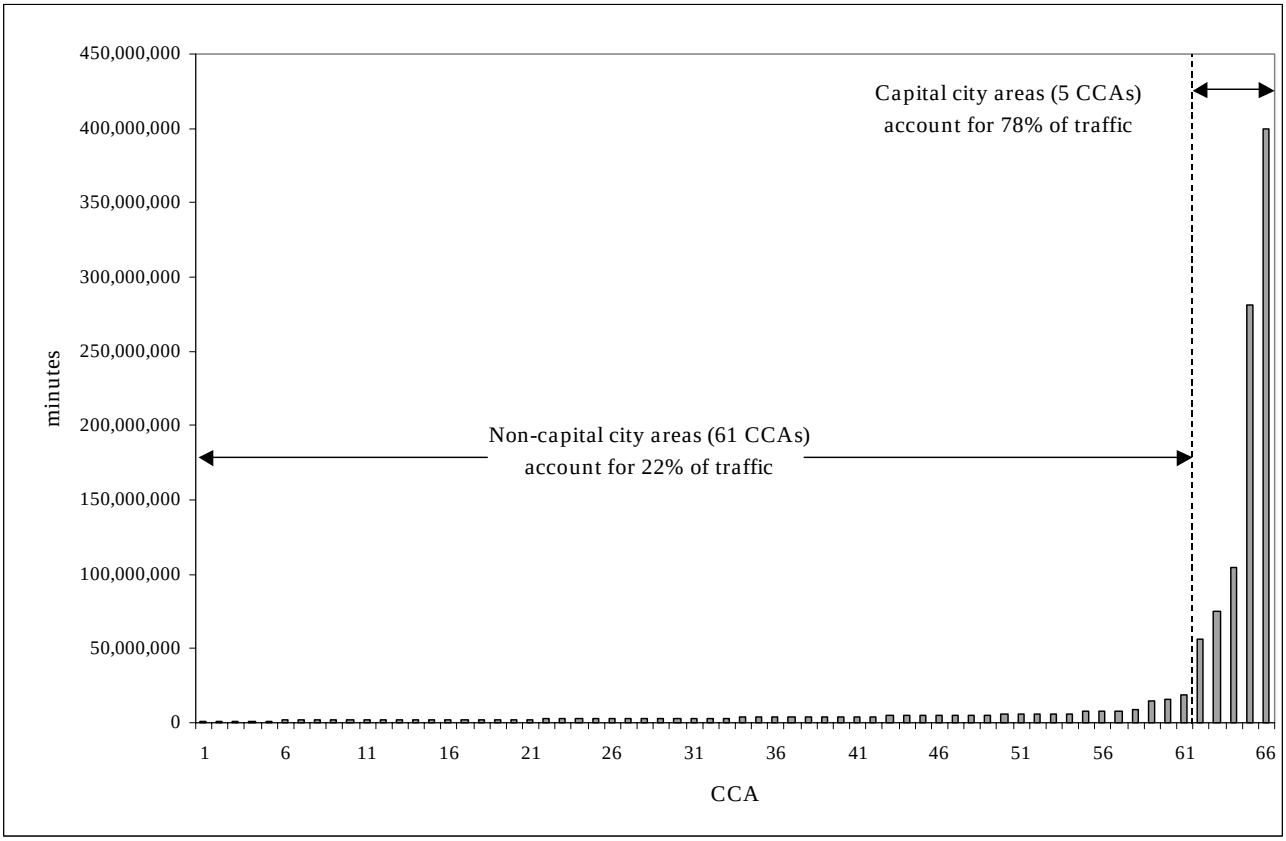


Source: Telstra

Another measure that provides information on the extent of competitor infrastructure is Telstra's access out-payments (see Figure 13). Where competitors have a local network in place Telstra will make a terminating access payment to that carrier when a call originates on Telstra's network and terminates on another carrier's network. As over 90 percent of local calls and a large proportion of STD calls originate on Telstra's network, the termination payments that Telstra makes to other carriers provides a useful indication of the extent of local network infrastructure operated by other carriers. This information reveals that the majority of traffic terminated by Telstra's competitors is in CBD areas. In fact, of total competitor termination traffic, 80 percent terminates in the five major CBD areas (Sydney, Melbourne, Brisbane, Perth and Adelaide). While there is also some traffic terminated outside of these areas, the durations of these calls indicate that this traffic is Internet traffic (ie local calls to ISPs) rather than voice traffic. For example, the average duration of competitor termination traffic for most of Telstra's competitor/carriers is 39 minutes per call. This compares with an average duration of 6 minutes for all traffic carried on Telstra's network. The stark difference in duration is a result of the call types carried by competitor traffic. In particular, the vast bulk of Telstra's competitors carry predominantly Internet traffic, that is, local call traffic to ISPs while Telstra carries a mix of data and voice traffic. Importantly, the infrastructure

investment required to terminate ISP traffic is minimal compared with the network investment required to compete for geographically dispersed voice traffic.

Figure 13: Competitor traffic by Call Charge Area, June 2000



Source: Telstra

The strength of this pattern is all the more remarkable when account is taken of the scope Telstra's competitors have to provide service. In particular, it needs to be remembered that Optus has rolled out a network that passes some 2.1 million homes; additionally, Optus has repeatedly asserted that this network is telephony capable – indeed, sworn statements by Optus senior executives, provided to the ACCC at the time of the proposed Foxtel / Australis merger, state that Optus could, if it so chose, provide telephony service to the majority of the homes passed by its network by 1999. In practice, Optus has minimised its reliance on its own facilities, with the exception of service in the CBDs, and has been imitated in this respect by Telstra's other competitors.

The pattern is also remarkable when it is contrasted with developments overseas. In the UK for example, alternative network is now widespread with nearly 20 percent of all lines in the UK provided by companies other than BT. Equally, even in New Zealand, where population density is relatively low, the development of alternative access networks has outstripped that in Australia, with Clear setting up optical-fibre networks in relatively small centres such as Christchurch and now in the process of a nation-wide roll-out of LMDS to business customers. In addition, Saturn, in a joint venture with Telstra, has committed to the extensive roll-out of competing local loop in the main centres as well as Dunedin, Hamilton and Tauranga. As the Draft Report of the New Zealand Ministerial Inquiry into Telecommunications notes, ".. a significant proportion of the population – at least two thirds on the basis of current roll-out plans – are likely to be the

beneficiaries of fixed local loop competition **within about three to five years**"[20]. It is surely striking that the roll-out plans announced by Telstra's competitors in Australia are far more limited in scope.

In Telstra's view, the highly concentrated pattern of network service provision by Telstra's competitors is overwhelmingly due to regulatory intervention.

It would be tempting, but wholly inaccurate, to suggest that it is the control over retail prices that is primarily at issue here. It is true that retail price regulation keeps rentals and local call charges at levels that are not cost-recovering. However, for most, though not all, customers, overall outlays on telecommunications services, including STD, IDD and Fixed to Mobile calls, more than cover the overall costs involved in service provision. As a result, the central issue for competitors is whether it is preferable to seek to secure that revenue through the provision of a network service that includes access and local calling, or alternatively, to seek to secure it by using Telstra's PSTN Ingress and Egress service – that is, the service by which competitors can secure and deliver traffic over Telstra local network. As a result, the primary factor determining the build/buy decisions taken by Telstra's competitors is the level of regulated access charges, and not the retail prices themselves.

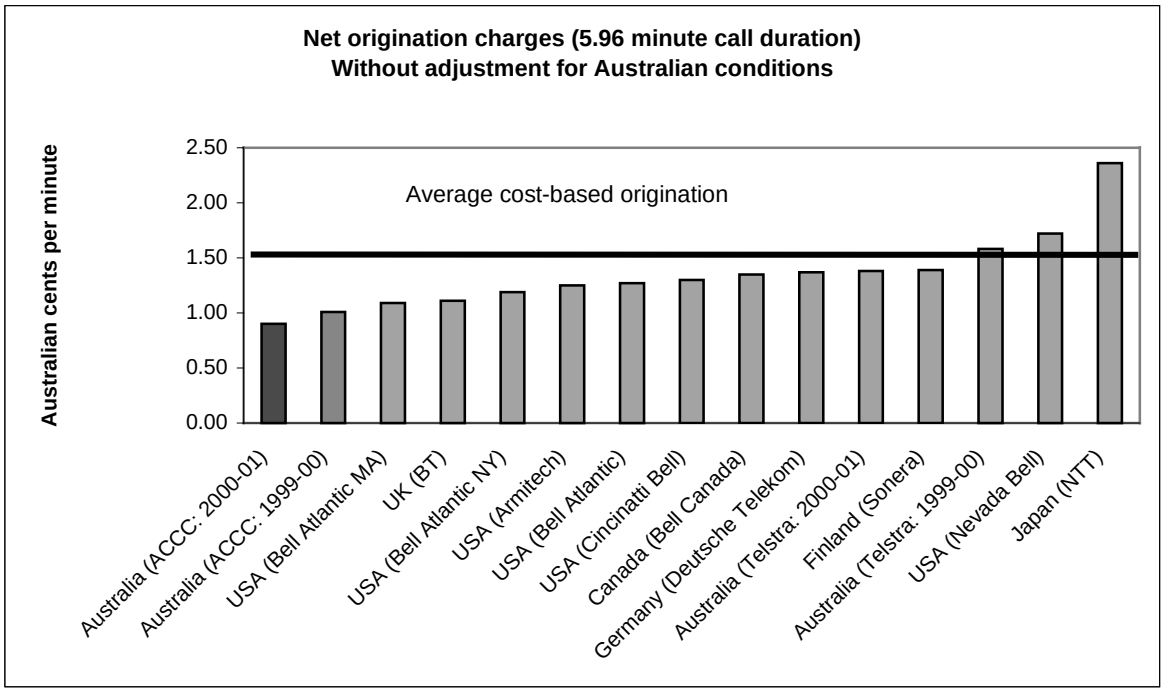
Seen in this light, the lack of competing network services in Australia is unsurprising. At a general level, it is well known that access regulation – that provides competitors with access at price-regulated charges to incumbent facilities – grants competitors the equivalent of a call option on the established network. As a result, it will, under most conditions, reduce the incentive they face to build networks of their own, especially when the option they have been granted can be exercised at prices that are set on a cost-of-service basis.

This general feature of cost-of-service based access regulation has been exacerbated by the ACCC's systematic tendency to set access charges at levels that are very low by any reasonable standard. It is, in particular, noteworthy that the charges that the ACCC has determined as being acceptable for Telstra's PSTN interconnection service are extraordinarily low by international standards. This conclusion is evidenced in Figure 14, which details the regulated PSTN origination charge proposed by the ACCC for the next two years and compares these with comparable charges elsewhere. The setting of charges at these very low levels, despite structural conditions (such as low population density) that on any reasonable assessment would cause costs of service to be materially above those in comparator countries, cannot but distort build/buy decisions.

---

[20] Ministerial Inquiry into Telecommunications Draft Report, June 2000 at page 42; emphasis added.

Figure 14: International Comparison of Interconnect Charges



Source: ACCC 2000, A Report on the Assessment of Telstra's Undertaking for the Domestic PSTN Originating and Terminating Access Service, July.

In Telstra's view, such a distorting effect is partly inherent in the costing methodology adopted by the ACCC, and most notably its emphasis on optimisation within a Total Service Long Run Incremental Cost ("**TSLRIC**") framework. From an efficiency point of view, competitors ought to build their own networks when the long run costs they will incur in doing so are below those Telstra will, as a matter of fact, itself incur over the longer run. The costs that Telstra *ought* to incur, or more generally would incur if it were run with perfect foresight, are irrelevant to this calculation: the proper price signal should reflect commercial reality as it is, not as an "omniscient social planner" might choose it to be.

This is readily seen by considering competitors' build/buy choice analytically in the presence of the type of *ex post* cost optimisation effected by the ACCC. Thus, if competitors' costs prove to be higher than Telstra's, then competitors will be better off if they have chosen to 'buy' rather than to 'build'. Conversely, if Telstra's costs prove to be higher than they could be, then regulatory optimisation will ensure that the excess costs are "optimised out": making competitors no worse off from relying on Telstra's network than they would have been had they built facilities of their own. In short, optimisation, as practiced by the ACCC's approach to cost modelling, insures Telstra's competitors against suffering any harm by 'buying' rather than 'building', and hence deters competing investment.

The resulting biases are aggravated by the approach the ACCC has adopted to the practical implementation of its preferred cost standard. The application of TSLRIC requires numerous assumptions and judgements regarding parameter inputs and methodologies. The results produced from a TSLRIC model are extremely sensitive to the set of input values and methodologies adopted. For example, by altering just two input parameter values and the methodology used to calculate depreciation, the TSLRIC model developed by the ACCC's

consultant NERA on PSTN cost modelling, produces a line cost estimate of either $423 or $339, a difference of 25%[21].

Given this variability, it is considered reasonable internationally to use the TSLRIC models to produce a range of reasonable access price estimates. A commercially negotiated access price that falls within this range would generally be considered acceptable. The NERA report to the ACCC on PSTN costings, for example, provided a range of estimates using high and low end parameter estimates as model inputs.

It would appear that the ACCC, on the other hand, has carefully selected parameter values that ensure that its estimates are at the bottom of the range that can be generated by a TSLRIC model. It has done this in numerous ways. For example, in the case of PSTN originating and terminating access:

- Instead of estimating the stand-alone costs of the PSTN service, the ACCC has shared out the PSTN costs to other services such as ISDN and leased line services. Since the ACCC has ignored many of the costs involved in providing these other services, this sharing significantly reduces the cost attributed to the PSTN originating and terminating access service;

- The ACCC has assumed substantially more trench sharing than Telstra actually achieves in practice;

- The ACCC assumes network provisioning levels that are inconsistent with efficient dimensioning and network operation and with the Customer Service Guarantees within which Telstra is required to perform;

- The ACCC allocates more costs to local calls than can be recovered given the price control arrangements, thus requiring Telstra, and Telstra alone, to bear the burden of regulatory price constraints; and

- The ACCC has used an annuity approach to annualising capital costs, completely ignoring the risk of asset stranding, instead of using economic depreciation as advised by its own consultants, NERA.

Telstra estimates that the combined effect of these choices made by the ACCC is to reduce charges for PSTN Ingress and Egress service by at least 33 per cent. In addition, the ACCC has adopted the same parameter values in estimating the cost of the declared unbundled local loop price resulting in an access price for this service of $36 per month, only slightly above half of the price proposed by Telstra ($63 per month)[22].

The economic consequences, notably on build/buy decisions, of setting regulated access prices at levels that are, in Telstra's view, unrealistically low are aggravated by the ever wider reach of the regulated access regime. Since the enactment of Part XIC (the current telecommunications access provisions) in 1997, the ACCC has dramatically extended the scope of the regulated access arrangements. The Explanatory Memorandum to Part XIC illuminates Parliament's intentions by stating that Part XIC is not intended to regulate access to services where competitive supply already operates. It states that:

---

21 See NERA 1999, Estimating the Long Run Incremental Cots of PSTN Access, Final Report for the ACCC.

22 ACCC 2000, Pricing of Unconditioned Local Loop Services and Review of Telstra's Proposed ULLS Charges, Discussion Paper, August.

> "It is not intended that the access regime embodied in this Part impose regulated access where existing market conditions already provide for the competitive supply of services. In considering whether a thing will promote competition, consideration will need to be given to the existing levels of competition in the markets to which the thing relates".[23]

Despite this clear statement of Parliament's intention, the ACCC has extended regulated access arrangements to inter-capital transmission, which is plainly a market in which there are competing sources of supply. The carriage of Pay TV by analogue means over Hybrid Fibre Coaxial networks has also been brought within the access arrangements, with the ACCC simply disregarding the competition that comes from satellite Pay TV operators, even putting aside Free-to-Air. Equally, the ACCC has threatened to bring GSM roaming, a vigorously competitive market, within the arrangements, if commercially negotiated outcomes departed from the Commission's preferred path of market development.

Overall, out of the all of the services that have been considered for declaration (the means by which services are brought within the scope of the regulated access arrangements), the ACCC has rejected declaration on only 2 occasions. The result is that as matters now stand, over 50 percent of the revenues associated with Telstra's fixed network services fall within the scope of the Part XIC regime. With the implementation of the unbundled local loop service later this month, 100 percent of the revenues associated with Telstra's fixed network services will, to some extent, be subject to industry specific regulation.

In Telstra's view, such extensive regulatory reach, when combined with a systematic bias in the setting of access charges, cannot but reduce, or even entirely eliminate, competitors' incentives to develop their own facilities. To begin with, competitors are assured of access to virtually all the network inputs required to provide service – be it for traditional voice telephony or for newer, riskier, services such as data transmission and Pay TV – without themselves needing to incur the cost and uncertainty that facilities investment entails. At the same time, competitors have been sent a clear signal that the terms on which this access will occur will not be such as to disadvantage them relative to the option of network roll-out.

Telstra submits that the observed pattern in the development of competition – which is one in which intense competition in the more lucrative markets is paralleled by little competition in the supply of access and local calls – reflects these regulatory distortions. This Inquiry ought therefore to pay close attention to these regulatory distortions and to the scope for winding them back.

1.6 Implications for public policy

A decade of liberalisation has brought substantial gains to Australian consumers of telecommunications services. Thus, Telstra estimates that for four services alone (local calls, STD calls, international calls and fixed to mobile calls), the price falls achieved over the period from June 1996 to June 1999 provided Australian consumers with a gain, in terms of additional consumer surplus, that can be valued at over $58 million per month.[24]

In Telstra's view, these gains would be even greater if the regulatory distortions that currently weigh on competition were removed. More specifically, considerable benefits would flow if the

---

[23] Trade Practices Amendment (Telecommunications) Bill 1996, Explanatory Memorandum, p.41.

[24] The total transfer to consumers – that is, the amount by which consumers are better off from the price falls – of course greatly exceeds this amount, as the increase in consumer surplus measures the change associated with increased consumption and ignores the gain made on the units that would have been consumed in any event.

impediments to efficient investment, and notably to investment in competing networks, could be eliminated. These benefits have been expressed in the following terms:

> "Facilities based competition is much more beneficial to economic efficiency than is resale competition… Facilities based competition creates important dynamic economic efficiencies as carriers compete to lower their costs so they can lower their prices. Carriers also compete to offer new services to consumers which are another important form of dynamic efficiency. To the contrary, resale competition does not cause these dynamic economic efficiencies to occur… Facilities based competition [also] eliminates the need for further regulation because market based competition determines prices and services offered"[25]

Important as each of these factors is, the gains from removing impediments to efficient investment would go even further than this quotation suggests.

At present, there is significant uncertainty internationally as to the identity of the optimal access technologies of the future. As the demand for broadband services grows, carriers around the world are experimenting with various delivery technologies from satellite, to terrestrial wireless, to cable, through to enhanced copper pair technologies such as ADSL. Over the longer term the market will undoubtedly identify the optimal technology or technologies. However, in Australia, this competitive process is undermined by the regulatory disincentives to investment. Access prices that deter the development of competing networks will reduce the range of approaches that can be explored and tested, and hence will make it less likely that the most efficient approaches to providing the services on which an information-oriented, internationally competitive, economy depends will be identified and rapidly and widely made available.

Removing the disincentives to efficient investment requires a fundamental reconsideration of the basis and direction of telecommunications policy.

Throughout the period from the early 1990s, successive governments have described telecommunications regulation as transitional – as a stepping stone on the path to full liberalisation and reliance on the general, economy-wide instruments of competition policy. Industry-specific arrangements, and the continuance within these of highly intrusive forms of intervention, have been justified by reference to the relative immaturity of the competitive process, and by the alleged need to protect and promote the development of competition.

Telstra queries whether these justifications are in any way consistent with the evidence that has been set out above. The fact of the matter is that whenever markets have been opened to competition, competitors have had little difficulty in securing strong, defensible positions in the liberalised markets. To claim that this is the result of regulation flies in the face of international experience, for there is little or nothing to suggest that competitors have had greater difficulty in establishing themselves in relatively light-handed regulatory regimes – such as Sweden, Finland and New Zealand – than they have in countries, such as Australia, where regulation has been more intrusive.[26] Rather, what the evidence suggests is that the barriers to entry into telecommunications have been greatly and persistently over-stated.

---

[25] J. Hausman, cited in Cable & Wireless Optus, Submission to the Productivity Commission's Inquiry into International Telecommunications Market Regulation, p. 15, www.pc.gov.au

[26] Competitors may nonetheless have secured far greater wealth transfers in the more intrusive regimes, but it is far from clear that such transfers do anything to promote competition.

All of this throws doubt on whether the choices made in the past with respect to the regulation of telecommunications were well founded. But consideration of the past is far less important than using an understanding of the present to inform the choices that must be made in the future.

More specifically, Telstra believes that claims that continued "infant competitor" protection is required are unsustainable. Today, 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" 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.

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.

To begin with, 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 and of the largely unregulated mobile services. 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 to Part XIC (that have made it more attractive than ever for competitors to seek access on arbitrated rather than commercial terms[27]), have dramatically over-loaded the regulatory mechanism.

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 increased 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 estimated 27 active arbitrations, 10 have been going for 12 months or longer.[28] This is, Telstra submits, a regulatory mechanism that is simply not working. The extent of the overload, combined with an understandable desire by the ACCC to be seen to be resolving the disputes it is charged with arbitrating, can only increase the risk of regulatory error.

---

27 The 1999 amendments to Part XIC allow the ACCC to make interim arbitration determinations which: are not reviewable by the ACT; are binding upon the parties until a final determination is made by the ACCC; and do not require the ACCC to not take into account the LTIE criteria. Additionally, these amendments prevent a party that wishes to challenge a final arbitration from 'staying' the effect of the arbitration when appealing to the ACT or on administrative law grounds to the Federal Court. Finally, they allow the ACCC to backdate the effect of its access determinations to the time of the dispute.

28 It is sometimes asserted that the long lengths involved in these arbitrations are the result of Telstra delaying the process. Telstra disagrees that it has imposed unnecessary delay on the arbitration process and notes that 4 of the 10 longest arbitrations do not involve Telstra at all, and hence the long length of these arbitrations could not possibly be a result of Telstra delaying the process. Non-Telstra disputants are also involved in drawn out arbitration proceedings. For example, the ACCC is still yet to decide: disputes lodged by AAPT in June 1999 against Optus in relation to domestic PSTN originating and terminating access; and further disputes lodged by AAPT in July 1999 against Optus in relation to GSM originating and terminating access.

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.

Telstra therefore believes that the time has now come to bring the telecommunications industry into line with the rest of the economy. More specifically, in this submission, Telstra argues that the current Part XIC should be reformed to provide constraints on regulatory discretion on a basis similar to Part IIIA of the Trade Practices Act; and that Part XIB of the Trade Practices Act should be repealed.

Telstra recognises that its competitors will assert that conditions are not yet ripe for a move away from "infant competitor" protection. Telstra believes that the Productivity Commission will not find this surprising, as "sheltered infants" have never, in the Australian experience, been supportive of changes that would erode their ability to secure further rents. Nor will it be surprising if the regulators, whose power is maximized by retaining the current arrangements in place, endorse a regulatory scheme that is not only economically inefficient but clearly incapable of efficient administration.

Ultimately, the Competition Principles Agreement, that binds the Commonwealth, requires that the onus of demonstrating the public benefit from regulations rests on those who would maintain those regulations in place. Applying this test rigorously and independently to the telecommunications industry will provide an important opportunity to place telecommunications regulation on a surer, more economically sensible basis.

2 Part XIB of the Act: legislation in need of repeal

2.1 Introduction

Within the context detailed in section 1, Telstra submits that Part XIB is redundant and its retention has the very real potential to impose further significant costs on Australia consumers. Specifically, Telstra submits that Part XIB of the Act should be repealed as:

- experience since 1997 shows that the matters investigated and pursued by the ACCC under the competition rule in Part XIB could all have been investigated and pursued under Part IV of the Act;

- the costs of Part XIB, in terms of the risk of regulatory errors and the dampening of pro-competitive conduct by Telstra, outweigh any benefit; and

- the onus is on those who wish to retain Part XIB to justify its retention: Part XIB was introduced as a temporary exception to the principle of having competition laws of universal application and the arguments put forward to justify an industry-specific regime for telecommunications are no longer valid (if they were ever valid). Such justification has not been forthcoming.

This section first reviews the experience to date with Part XIB and explains why all of the investigations to date could have been pursued under Part IV of the Act. The next part of this section examines the costs associated with Part XIB in terms of regulatory error and restrictions on competition. This follows with a section that examines each of the original reasons posited for the introduction of Part XIB and finds that none of these reasons provides a sufficiently strong argument to warrant supplementation of Part IV. This section concludes by considering the scope for repealing or reforming Part XIB of the Act. For the benefit of the Commission, the structure and contents of Part XIB are summarised in Attachment B.

2.2 Experience under Part XIB

Part XIB has proved unnecessary. Telstra has not been found by a court to contravene 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.

For example, the ACCC has issued eight competition notices under Part XIB since 1 July 1997. Two of these related to Internet peering and six related to commercial churn. In neither matter was there a court finding that Telstra had acted in breach of the competition rule, nor any concession by Telstra that it had breached the Act. These two matters represent the "high points" of the ACCC's use of its powers under Part XIB, yet both matters, as may be seen from the following discussion, could have been run under Part IV of the Act. As such, Part XIB is unnecessary.

Similarly, investigations by the ACCC into Telstra's "$3 STD Deal" and "Switchports" could have been run under Part IV. As explained below, the ACCC did not find any breach of Part XIB in either of those investigations.

Internet Peering

The first competition notice was issued in May 1998, some 10 months after the ACCC was given the power to issue such notices.

The notice alleged that Telstra was in breach of the competition rule by charging its Internet access provider ("**IAP**") competitors for certain services while at the same time not paying for similar services received from those IAPs.

The initial notice was replaced early in June with a revised notice. The revised notice was also withdrawn after Telstra finalised "peering" agreements with the three IAPs in question.

Telstra never considered that its conduct was in breach of the Act, but the blunt pressure from the ACCC threatening to issue a competition notice caused Telstra to enter into negotiations with the IAPs which culminated in peering agreements even though none of the IAPs had a comparable network or a comparable volume of traffic at the time to qualify it as a "peer" of Telstra.

In this matter, the ACCC did not need Part XIB as it could have brought its allegations under Part IV of the Act. It could have alleged, for example, that Telstra had refused to "peer" in breach of section 46 (alleging an anti-competitive purpose instead of the allegation of an anti-competitive effect). Alternatively, if the ACCC wanted to avoid having to prove Telstra's purpose and preferred to rely on an allegation of an anti-competitive effect, it could have argued that Telstra's existing agreements with the IAPs contravened section 45. A further alternative would have been to deal with the matter as an access issue under Part XIC.

Commercial Churn

Following the Internet peering notices, the ACCC waited another year before issuing its next competition notice. The ACCC then issued a series of six competition notices between August 1998 and April 1999 in respect of Telstra's commercial churn service.

The ACCC alleged that various terms and conditions under which Telstra offered to churn a customer's services or account from Telstra to a service provider which was reselling Telstra's telephony services, were a use of Telstra's market power and had the effect or likely effect of substantially lessening competition. The ACCC was particularly concerned with the prices charged by Telstra, notwithstanding that Telstra had set its prices conservatively at levels which were below its actual costs of providing the service.

Although Telstra maintained that it had not breached the competition rule, Telstra felt obliged to reduce its prices further below its costs as a result of the regulatory pressure brought to bear by the ACCC under its Part XIB powers.

The commercial churn notices were the subject of extensive Federal Court litigation, commencing in December 1998 and concluding in February 2000 when the ACCC discontinued the proceedings in light of the extensive evidence filed by Telstra.

As a result of the ACCC's use of its competition notice powers, the outcome in this matter was not fast, cheap or efficient:

- the proceedings ran for over 12 months without reaching a substantive hearing;
- the proceedings involved both the ACCC and Telstra incurring substantial costs and diverting significant resources from other activities; and

- the below-cost pricing resulted in an inefficient level of transfers and an inefficient transition path for service providers on to Telstra's wholesale billing platform (Linx Online) which provides greater customer transfer functionality at lower cost.

The ACCC could have relied upon Part IV of the TPA, alleging a breach of section 46, rather than relying upon Part XIB. Alternatively, the ACCC could have relied upon Part XIC by declaring the commercial churn service. Either way, Part XIB was not needed.

$3 STD Deal

On 16 October 1998, the ACCC wrote to Telstra investigating an allegation of a breach of the competition rule by Telstra. The complainant had alleged that Telstra was acting anti-competitively by charging its wholesale customers a timed, peak interconnect rate for some of the time period during which Telstra's $3 STD deal (which provided a capped retail price for STD calls of $3 per call between 7pm and midnight on weeknights). It was alleged that the effect of this conduct was that Telstra's competitors were unable to compete for residential long distance customers.

The ACCC investigated this matter over a period of almost 12 months before accepting Telstra's explanation that it was not acting in breach of the Act. During this period, Telstra answered numerous enquiries from the ACCC, made a number of submissions to the ACCC and attended a number of meetings with the ACCC. From the outset, Telstra had sought to explain to the ACCC why this matter did not involve any unlawful "price squeeze", but it took a long time and a lot of costs for Telstra to respond to the ACCC's investigation and satisfy the ACCC that Telstra was acting lawfully.

This is another investigation that the ACCC could have handled under section 46 of Part IV in that the allegation effectively was that Telstra had used its market power to set interconnection rates for a competitor at levels which prevented or deterred that competitor from competing. If there had been any truth in this allegation, it would not have been difficult to show or infer an anti-competitive purpose on the part of Telstra. Alternatively, it could have been argued that Telstra's agreement with its competitor establishing the rates for inter-connection had the purpose or the likely effect of substantially lessening competition. Again, Part XIB was unnecessary.

In addition, the matter illustrates the costs to Telstra of meeting these sorts of allegations under Part XIB. Telstra not only incurs the cost of substantial investigations (under threat of the issue of a competition notice), but also the pressure on Telstra to act conservatively in making competitive pricing decisions. In this matter, Telstra was seeking to meet retail competition from its competitors, yet Telstra's attempts to compete were being hampered by allegations of anti-competitive conduct and investigations by the ACCC.

Switchports

Switchports are ports on the trunk side of Telstra's exchanges which are necessary for access seekers to interconnect with Telstra's network. Due to a significant increase in demand over the last year (in large part attributable to internet service providers taking advantage of arbitrage opportunities), Telstra's switchport capacity has become constrained.

A few carriers recently made allegations that Telstra had breached the Act, both in respect of Part XIB by refusing to supply adequate switchports and under Part XIC by failing to comply with its standard access obligations.

Following an investigation into this matter, the ACCC issued a media release on 7 July 2000 stating that it did not have a reason to suspect that Telstra had contravened, or was contravening, the competition rule in Part XIB of the Act. The ACCC was satisfied that Telstra had been trying to respond to significant, unprecedented increases in inter-connection forecasts from the industry.

Again, the allegation and investigation in respect of Part XIB of the Act could have been handled as a matter under section 46 in Part IV of the Act. Part XIB, therefore, was unnecessary in respect of this matter.

2.3 Costs of Part XIB

Telstra submits that Part XIB imposes potentially significant costs on the Australian community by:

- increasing the scope for litigation; and
- increasing the likelihood of regulatory failure.

Increased litigation

By lowering the legislative and procedural hurdles for regulatory intervention, Part XIB – particularly with the amendments made in 1999 – significantly reduces the litigation costs incurred by regulators and complainants in individual cases.[29] However, the impact on total administrative costs is less clear. Policy-makers do not appear to have considered the increase in total administrative costs that inevitably occurs as a result of lowering the evidentiary threshold and hence increasing the incentives for potential complainants to complain to the ACCC.

Part XIB is essentially a "one way bet" as far as complainants are concerned. Their costs are socialised; the worst that can happen is that the ACCC decides not to proceed with a complaint. As a result, the system exhibits none of the effects that the common law rule of cost allocation has in deterring low-probability claims under s.46.[30] The ACCC's failure to articulate any clearly defined tests for determining the merits of complaints makes a strategy of complaint all the more attractive. Had the ACCC set out bright line tests, those considering initiating a complaint might have been more cautious, for fear of acquiring a reputation with the ACCC of being merely vexatious. In fact, the ACCC's Telecommunications: Competition Notice Guidelines (1997) are merely procedural, while its Information Paper Anti-competitive Conduct in Telecommunications Markets is vague and seems designed not to limit the ACCC's discretion.

Moreover, the assertion that reducing the legislative and procedural hurdles will reduce the administrative costs in individual cases does not stand up to scrutiny. While the Internet peering matter was over relatively quickly, the commercial churn matter continued for over 18 months with the parties to this matter expending prodigious sums of money on legal and economic advice and management time and energy.

---

29 Of course for the defendants, the costs do not decline.

30 Under the Common Law Rule, costs are borne by the losing party. The deterring effects of such a Rule on un-meritorious claims are examined in S. Shavell "Suit, Settlement and Trial: A Theoretical Analysis Under Alternative Methods for the Allocations of Legal Costs" 11 *Journal of Legal Studies* (1982) 55. While there is a lively debate as to the extent of this effect, the relevant literature leaves no doubt that a rule that removes any risk of loss from the complainant will reduce the quality of claims.

Increased chance of regulatory failure

The reduction in the legislative and procedural hurdles for intervention that is the function of Part XIB, coupled with the rapid growth and high levels of technological change that characterise the telecommunications industry significantly increases the chances of regulatory failure and the associated efficiency losses.

The Internet peering case illustrates these costs. The requirement to peer has probably imposed allocative efficiency losses as the immediate beneficiaries of the requirement to peer increase their demands on Telstra's backbone network. Further, productive inefficiencies arise, as potentially more expensive Telstra facilities are not replaced by more efficient facilities because the incumbent facilities under peering are effectively priced at zero. Finally, dynamic inefficiencies arise from a reduction in competitive activity (as there is clearly a risk of it being mistaken for anti-competitive conduct) and from a reduction in investment both by access-seekers and by access-suppliers.

The impact of any increased risk of regulatory failure on investment can be seen in the analysis of Bittlingmayer who examined a set of 21 major industries in the United States covering 1947-1991 to investigate the statistical association between antitrust case filings and investment.[31] Each additional antitrust case filing was found to be associated with a significant decline in investment in the industry at issue. There are many potential causes for this association, but the increased risk associated with antitrust activity, including the risk of regulatory failure, is considered pivotal.

In the Australian context there is some recent evidence that could indicate the detrimental impact of the Internet peering competition notices on investment. The evidence indicates that Telstra has increased its share of bandwidth capacity – with limited investment outside Sydney and Melbourne – suggesting that the ACCC's intervention has tended to lessen, rather than enhance, diversity and competition in the provision of Internet backbone services. 32

2.4 No basis for the introduction or retention of Part XIB

This section considers each of the original reasons posited for the introduction of Part XIB[33]. Telstra submits that none of these reasons provides a sufficiently strong argument to warrant supplementation of Part IV.

Telstra submits that Part XIB has in fact been unnecessary to regulate anti-competitive conduct in the telecommunications industry. In particular, Telstra notes that Part IV of the Act would have achieved much the same results as Part XIB, whilst providing greater certainty to industry participants, reducing the risks of costly regulatory errors and maintaining appropriate limits on regulatory discretion. It follows that Part IV would be sufficient, and preferable, to regulate anti-competitive conduct in the telecommunications industry beyond 2000.

---

31 See generally, Bittlingmayer G. (1999), Investment and Antitrust Enforcement., http://www.gsm.ucdavis.edu/~gnbittli/

32 See www.consult *9th IAP Report: Internet Access in Australia* (October 1999), page 19.

33 See generally, Exposure Drafts and Commentary to the *Telecommunications Bill 1996* and the *Trade Practices Amendment (Telecommunications Bill) 1996*, December 1995, pages 25 to 29; Explanatory Memorandum to the *Trade Practices Amendment (Telecommunications) Bill 1996,* pages 6, 7 and 10; and Second Reading Speech to the *Trade Practices Amendment (Telecommunications) Bill 1996.*

The need for speed

This rationale for the introduction of Part XIB was misconceived as the ACCC (and third parties) have always had the ability to seek interim, interlocutory and final injunctions from the Federal Court to put an immediate end to conduct that contravened Part IV of the Act.

The intention of Part XIB was to reduce administrative time and costs in the challenge of suspected anti-competitive conduct. In practice, Part XIB has greatly increased the scope for regulatory error (that is, mistaking competitive conduct for conduct that harms the competitive process)[34] without alleviating – and perhaps increasing - administrative delay. Furthermore, the incentives Part XIB creates to pursue regulated solutions may ironically lead to more rather than less litigation. The expanded powers conferred on the ACCC under Part XIB and the lack of accountability of the ACCC for its decisions under that Part have increased both the likelihood of errors being made by the ACCC and the severity of the consequences of those errors for industry participants. The result may be that there will in fact be more instances where firms will wish to defend allegations made in competition notices or subsequent proceedings, with consequential delays in resolving the issues.

The Part XIB cases discussed above provide substantial evidence of the lack of speed involved in the regime.

In the Internet peering matter, the ACCC issued the competition notices after a lengthy investigation belying the need for speed. As each of the IAPs was not in fact a "peer" of Telstra, the agreements were not required under the Act and the ACCC's resort to its power to issue competition notices involved a regulatory error that was costly for Telstra.[35]

In the case of the commercial churn notices, Telstra vigorously contested the claims contained in the notices in the Federal Court. On 23 February 2000, some 18 months after the first notice was issued in August 1998, the ACCC withdrew the notices, with Telstra not conceding any liability.36

Purpose or effect

Telstra is not convinced that the purpose test under section 46 of the Act is deficient, nor that any supposed deficiency is cured by an effects test. Section 46 is a strong and well-established competition provision that has been used to regulate anti-competitive conduct in a range of industries in Australia.

Section 46 differs from the Part XIB test for anti-competitive conduct in that it focuses on the purpose of the conduct rather than the effect of the conduct. An investigation of purpose is a more practical and limited exercise than an examination of effect, because an effect on competition involves complex issues of the extent of any lessening of competition. If there are arguments that favour an effects test over a purpose test, then section 46 should be amended to apply an effects test to the assessment of anti-competitive conduct in all industries, so that firms and consumers in all industries can reap the benefits from an effects test. A separate telecommunications-specific part of the Act is not necessary.

---

34 M Landrigan and T. Warren, 'Administrative Costs and Error Costs in Market Conduct Regulation: Two Case Studies', 2000 *7(3) Competition and Consumer Law Journal*, 224.

35 H.Ergas, 'Internet Peering: A Case Study of the ACCC's Use of its Powers under Part XIB of the Trade Practices Act 1974', forthcoming 2000 *8 Trade Practices Law Journal.*

36 See www.accc.gov.au / media / mr-30-00.htm.

Moreover, extensive access obligations are contained in Part XIC (and Part IIIA) of the Act. These obligations facilitate contestability and remove an incumbent's exclusive control over bottleneck facilities. This makes it questionable whether there is any rationale at all for industry-specific market conduct controls in the telecommunications industry above and beyond those controls applying to all industries.

Penalties

Similarly, a perceived need for greater maximum penalties to constrain the conduct of firms in industries characterised by substantial revenues does not justify the introduction of industry-specific competition law regimes. Part VI of the Act already provides procedures under which injunctions may be sought to restrain conduct that is suspected of contravening Part IV, and provides maximum penalties for a contravention of Part IV of $10 million for a corporation and $250,000 for individuals.

If appropriate, different penalties for different types of firms could be provided under Part VI of the Act for contraventions of Part IV. As an example, some countries have adopted maximum penalties for anti-competitive conduct that are determined as a proportion of a firm's annual revenue.

Telstra's size

The existence of a large-scale operation or substantial market power in an incumbent is also no justification for an industry-specific regime. The general competition laws have been specifically designed to prevent anti-competitive behaviour by entities with substantial market power. Telstra's size, and the relative size of its competitors, should not alter this assessment. The general competition laws have provided adequate protection for small firms confronting anti-competitive behaviour by very large firms (for example, Queensland Wire Industries successfully took on BHP, and Pont Data successfully took on the Australian Stock Exchange). In addition, Telstra's competitors are not small by the standards of Australian firms generally, and many have substantial global financial backing. Indeed, all of Telstra's major competitors are substantially owned by global telecommunications carriers, including some that are much larger than Telstra.

Complexity of telecommunications

Complexity is also no justification for industry-specific competition laws. Many industries are as complex as the telecommunications industry, such as software and biotechnology, and departures from the general competition laws have not been considered necessary for these industries.

Horizontal and vertical integration

Similarly, horizontal and vertical integration are features common to many industries. They usually exist due to commercial drivers to increase efficiency, and in this sense are pro-competitive. Under the general competition law, the existence of horizontal or vertical integration in an industry is taken into account, along with other factors, in assessments of whether market power exists and the effects of conduct on competition. Indeed, there can be no doubt that the general competition law has 'runs on the board' in dealing with abuse of market power facilitated by horizontal and vertical integration.

Foreclosure

Foreclosure is an issue of particular concern in all network industries. It is for this reason that access to essential facilities legislation is a central part of Australian economic regulation. Any deficiency in the supply of access to essential services provided by a vertically integrated firm with substantial market power to competitors in upstream or downstream markets is best addressed

through an access regime and certainly does not justify the introduction of telecommunications-specific competition laws dealing with anti-competitive conduct.

More generally, conduct rules should not be confused with rules designed to provide access to inputs that are important for downstream competition on reasonable terms, including prices that approximate the prices which would prevail in competitive markets (that is, prices based usually on efficient costs). Part XIC provides an access regime specific to the telecommunications industry. Competitive conduct laws are not appropriate and should not be applied to achieve the functions of an access regime. Whilst refusals of supply have been held to contravene section 46, Australian courts have had difficulty resolving the price at which a firm is then required to supply. For example, the Full Federal Court in the Pont Data case made an order that supply be at the price agreed by the parties in an earlier contract and commented that the court should be "slow to impose upon the parties a regime which could not represent a bargain they would have struck between them".[37]

In the New Zealand case of *Clear v Telecom*, the Privy Council upheld Telecom's argument that New Zealand's competition laws (similar to those in Part IV) do not prevent a firm from charging full opportunity cost for access to an essential facility, even though this might confer monopoly rents on the supplier. The Privy Council took the view that to the extent that monopoly prices caused concern, the elimination of those monopoly rents was a matter for regulatory intervention such as price controls or access regimes, and was not for resolution through the competition laws dealing with anti-competitive conduct.[38]

It follows from the Privy Council's reasoning that competitive conduct laws serve a different purpose to access regimes, to the extent that access regimes are designed to achieve supply at a price that approximates the price which would prevail in a competitive market (based on efficient costs).

Nonetheless, it seems that in its efforts to make use of Part XIB, the ACCC has attempted to force access solutions and in particular, low (even below cost) prices, through the application of competition laws.

For example, it is not apparent why the ACCC considered the issues in the Internet peering and commercial churn matters under Part XIB rather than Part XIC. The provisions of Part XIC would have placed a far greater discipline on the process in terms of the neutrality of the assessment and the depth of consideration that could be given to the complex issues involved in setting access conditions. Moreover, if an access regime had been warranted, Part XIC would have provided much better scope than Part XIB for the ongoing monitoring and revising of access conditions.

After all, this is what Part XIC was designed for.

---

37 *ASX Operations Pty Ltd v Pont Data Australia Pty Ltd* (1990) (1991) ATPR 41-069.

38 *Clear Communications Ltd v Telecom Corporation of New Zealand Ltd* (1992) 5 TCLR 166; (1993) 4 NZBLC 103; [1995] 1 NZLR 385.

Predatory cross-subsidies

Finally, concerns regarding the scope for predatory cross-subsidies are not particular to the telecommunications industry and are adequately provided for under the general competition law. This is particularly so in telecommunications where pervasive use of regulatory price controls severely limits the scope for any recoupment from predatory pricing further undermining the incentives for such behaviour.

2.5 Scope for Repeal of Part XIB

The state of competition in the telecommunications industry has changed significantly since July 1997. Most telecommunications markets are now very competitive with many aggressively competitive players and frequent new entry, and Telstra's market power in those markets has been greatly diminished or eliminated.

Since 1997, the average level of prices has fallen significantly, margins have been squeezed, the range of available services has expanded and there has been substantial innovation in price and service packages. These features are consistent with the concept of highly competitive and contestable markets.

Against this background, it follows that the main issue for the review of Part XIB should be whether there is any ongoing justification for a telecommunications-specific competition law regime, or whether it is now time to move competition regulation of the industry into line with Australia's general competition laws.

Telstra submits that the Productivity Commission should recommend the repeal of Part XIB on the strength of the arguments in this submission that:

- the ACCC has substantial and sufficient powers to regulate anti-competitive conduct in all industries, including telecommunications, under Part IV of the Act;

- whether or not there was any justification for the introduction of Part XIB and subsequent amendments, no such justification continues to exist, given the healthy state of competition in the industry;

- in any event, experience has shown that Part XIB has been unnecessary for the restraint of anti-competitive conduct in the industry and that the issues which have arisen could have been handled under Part IV of the Act or under Part XIC of the Act (particularly given that Part XIC is likely to remain in place to ensure that firms with control of essential telecommunications services are not able to take advantage of that control to the detriment of efficiency and the competitive process); and

- the ACCC's additional powers under Part XIB, and the lack of appropriate procedural and merits review of the use of those powers, create a significant risk that if Part XIB is not wound back, much legitimate pro-competitive conduct, investment and innovation will be deterred, causing significant harm to both static and dynamic economic efficiency and short, medium and long-term consumer welfare, particularly given the highly dynamic nature of the telecommunications industry.

If the "effects" test is considered preferable to the purpose test, or if significantly different penalties are required for firms which behave anti-competitively in telecommunications markets, these considerations should be met by amending Parts IV and VI of the Act respectively, without the need for an industry-specific competition law regime.

No strengthening of Part XIB is required

Telstra submits that Part XIB does not require any strengthening to address:

- perceived delay in restraining anti-competitive conduct through the Part XIB regime; or

- the inability of competition notices to act as a cease and desist power in the hands of the ACCC.

These concerns are fully addressed by the ACCC's current ability under Part XIB (or Part VI) to apply to the courts for an interim injunction. Any delays in the issue of competition notices have been caused by the way in which the ACCC has chosen to exercise its powers, and the internal processes it has followed, rather than any deficiency with the Part XIB regime. In fact, to the extent that competition notices in their current form do tend to act as effective "cease and desist" orders, Telstra has made submissions regarding the potential costs to efficiency and consumer welfare of the power the ACCC does currently wield in the industry by virtue of Part XIB.

3 Part XIC: Access Regulation: a Regime in Need of Reform

3.1 Introduction

This section specifically reviews the performance of Part XIC of the Act. It shows that the declaration process, as applied by the ACCC, is characterised by systematic regulatory over-reach. 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.

The first part of this section examines the extent of regulatory discretion available under Part XIC by reviewing the ACCC's implementation of the regime's declaration provisions. The second part of this section identifies a number of the reasons why Part XIC is particularly susceptible to regulatory over-reach by comparing the declaration provisions of this regime with that of the general access provisions under Part IIIA. The final part of this section highlights problems with the implementation of the determination process of Part XIC by examining the undertaking and arbitration experiences.

3.2 Regulatory Discretion

The discretion available to the regulator under Part XIC of the Act is arguably most obvious with respect to the declaration provisions. Declaration is the process by which a right of access to eligible services is provided. Once declared, a service is subject to a set of standard access obligations ("**SAOs**"), one of these being a requirement to supply the service to access seekers. In principle, declaration can occur through one of three mechanisms – deeming, recommendation from the Telecommunications Access Forum or after a public inquiry. In practice, the only process by which services have been declared since the transitional deeming arrangements is after a public inquiry run by the ACCC.

The objective of the public inquiry process is to assist the ACCC in determining whether declaration of the service at issue would be in the long-term interests of end-users – the so-called LTIE test[39]. In fulfilling this test, three secondary objectives are considered that, if achieved, are believed sufficient to promote the long-term interests of end-users:

- Does declaration promote competition in markets for carriage services and services supplied by means of carriage services (listed services);
- Does declaration promote the achievement of any-to-any connectivity; and

---

[39] This is set out in section 152AB of Part XIC

- Does declaration encourage the economically efficient use of, and economically efficient investment in, the infrastructure by which telecommunications services are supplied?

In practice, Telstra submits that the ACCC has focused almost exclusively on the promotion of competition, with very little, if any, attention afforded to economic efficiency. Of the services declared by the ACCC, most go well beyond the original purpose of providing access to essential facilities. In particular, the ACCC has declared services where market failure is not apparent, where substitute services are already declared and services where the delivery technologies are changing rapidly (a full list of the declared services is provided in Attachment D). These declarations are likely to be costly in terms of economic efficiency and it is not clear, nor has it been demonstrated by the ACCC, that these costs would be outweighed by the short-term benefits associated with access-based competition.

Declaration in the absence of market failure

The ACCC has declared services where competition in supply already exists and hence regulated access is *prima facie* unnecessary. The ACCC's variation of the deemed transmission service is a case in point. In this inquiry, even according to the ACCC's own analysis, there was competition for transmission capacity. At the time of declaration there were already two carriers (Telstra and Optus) providing this service, with a number of potential entrants considering the provision of transmission capacity between capital cities. Nevertheless, the ACCC considered declaration of the transmission service to be necessary to further promote competition. The ACCC stated that:

> "Since the opening of competition, there have been dozens of new participants, both carriers and service providers, who are starting to make in-roads, particularly in relation to national and international long-distance services. However, as compared to other countries with more competitive transmission services, price gains made in Australia are not significant and this seems most apparent for data and IP-based services — services which most require high capacity long-distance transmission."[40]

Based on the perceived need for stronger price competition, the ACCC believed it to be necessary to declare the service.

Another example is the declaration of ISDN originating and terminating access. In that inquiry, the ACCC noted that it was not aware that Telstra had refused access or was charging inappropriate prices.[41] However, the ACCC was persuaded that declaration would assist in the resolution of technical issues; and that the "backdrop of Commission arbitration" would persuade parties to agree over the terms and conditions of access to services. On this basis the ACCC declared ISDN services.

Even in inquiries where the ACCC decides not to intervene, its propensity for over-reach is apparent. In the GSM roaming decision, the ACCC found that roaming would be provided on commercial terms without the need for declaration and it therefore did not declare Intercarrier Roaming services. Nevertheless, the ACCC threatened to "declare" and to regulate roaming under its market conduct powers if it found commercial processes to not be satisfactory.[42]

---

40 ACCC – Public Inquiry into Competition in Data Markets, p.80. Emphasis added.

41 ACCC Public Inquiry into Competition in Data Markets, p.38. Emphasis added.

42 ACCC Public Inquiry into Declaration of Domestic Intercarrier Roaming, p.v.

By declaring services or threatening to declare services that are competitively supplied, the ACCC appears to have interpreted the purpose of Part XIC more broadly than was originally intended by Parliament. The Explanatory Memorandum illuminates Parliament's intentions by stating that Part XIC is not intended to regulate access to services where competitive supply already operates:

> "It is not intended that the access regime embodied in this Part impose regulated access where existing market conditions already provide for the competitive supply of services. In considering whether a thing will promote competition, consideration will need to be given to the existing levels of competition in the markets to which the thing relates".[43]

Declaration of such services has the very real potential to result in significant productive and dynamic efficiency losses in the form of under-investment, limited innovation and foregone cost reductions. Indeed, during the public hearing into the inter-capital transmission declaration, potential entrants indicated that declaration would inhibit deployment of new technologies for supplying the declared service. Despite this, the ACCC declared the transmission service.

Multiple declarations of substitute services

Besides declaring services where evidence of market failure is not apparent, the ACCC has declared services for which alternative services are already declared and hence regulated access is *prima facie* unnecessary. It is difficult to understand how a local call resale service can be seen as a bottleneck, when a local PSTN originating and terminating service has already been declared. All such multiple declaration does, is provide access seekers with substantial arbitrage opportunities.

For example, the ACCC has declared three services for delivering local calls and has drafted pricing principles which propose inconsistent charging arrangements. The local PSTN originating and terminating service is to be charged on a timed charge determined by the application of TSLRIC. The local call resale service is to be charged on a per call charge based on a retail minus avoidable cost calculation. The unbundled local loop service is to be charged on a per line basis at a level consistent with TSLRIC. Hence access seekers can choose which service to use for customer groups with different traffic profiles with the objective of minimising total access charges. For example, the local call resale or unbundled local loop services would be used to provide services to customers that make long duration calls as these charges are not timed. Access seekers can (and do) use the PSTN originating and terminating access service to provide short duration calls as these charges are timed. As Telstra is constrained by retail price regulation (including pricing parity conditions) it is impossible to match the retail charges set by competitors using these declared services and still recover costs.

Declaration of technologically dynamic services

Additionally, the ACCC has declared a number of services where technologies are new or are changing rapidly. In such situations, any potential bottleneck is likely to be highly transitory. For example, the ACCC declared the ISDN service and failed to revoke the declaration of the digital data access service ("**DDAS"**) presumably on the basis that these services represented bottlenecks in the supply of high-speed data services. However, the technologies used to deliver high-speed data services are changing rapidly. Narrowband technologies such as DDAS and ISDN are not necessarily the most efficient technologies for the delivery of data services, with broadband services such ADSL, cable modem and satellite offering superior service options. These new technologies are supplied competitively. Hence, the declaration of DDAS and ISDN services was unnecessary and as a precedent may well discourage investment in new alternative technologies.

---

[43] Trade Practices Amendment (Telecommunications) Bill 1996, Explanatory Memorandum, p.41.

Moreover, the tendency for the ACCC to make technology specific declarations, such as the ISDN and analogue Pay Television services, is particularly costly. Declaration means that the access provider is required to keep providing the service over the specified technology. This results in productive efficiency losses, as the access provider is forced to continue providing the service over the declared technology where it otherwise may not in the absence of a regulatory direction. Together with the application of the ACCC's approach to price regulation, this type of declaration will also give rise to allocative and dynamic inefficiencies as consumption and investment decisions will be distorted as 'optimised' access prices do not reflect the actual cost of providing these antiquated services.

3.3 A comparison of Part IIIA and Part XIC

The regulatory over-reach that characterises the operation of Part XIC is primarily an outcome of a number of significant shortcomings with the legislation. These are apparent from a comparison with the operation of Part IIIA, which contains a series of procedural hurdles that constrain the scope for regulatory over-reach. In particular, unlike Part XIC, Part IIIA is subject to a number of clearly defined rules-based criteria, merits review, sunset clauses and political economy constraints.

Clearly defined, rules-based criteria

Under Part IIIA, the declaration process is subject to a number of clearly defined rules-based criteria that are structured as a series of hurdles, each of which must be overcome before the National Competition Council ("**NCC**") can declare a service. Specifically, the NCC cannot recommend that a service be declared unless it is satisfied as to each of the following matters:

a) that access (or increased access) to the service would promote competition in at least one market (whether or not in Australia), other than the market for the service;

b) that it would be uneconomical for anyone to develop another facility to provide the service;

c) that the facility is of national significance, having regard to:

   i. the size of the facility; or

   ii. the importance of the facility to constitutional trade or commerce; or

   iii. the importance of the facility to the national economy;

d) that access to the service can be provided without undue risk to human health and safety;

e) that access to the service is not already the subject of an effective access regime; and

f) that access (or increased access) to the service would not be contrary to the public interest.[44]

In contrast, Part XIC lacks hurdles that must be passed before an access declaration can be made. Rather, as noted above, there is a series of factors (the LTIE test) that the ACCC must have regard to when considering declaration.[45]

---

[44] See section 44H (4) (a)-(f)

[45] See section 152AB (2) (c)-(e)

The requirement under Part XIC that the ACCC 'must have regard' to the criteria as opposed to the Part IIIA requirement that the designated Minister 'cannot declared a service unless he or she is satisfied of all' the listed hurdles vests great discretion in the ACCC over which criteria it emphasises. Telstra submits that in practice the ACCC has sought to exercise this discretion by favouring the promotion of competition over the other regulatory objectives – any-to-any connectivity and the encouragement of economically efficient investment.

Merits review

One of the most significant constraints on regulatory over-reach under Part IIIA is the ability of an access provider to have declaration decisions subjected to a full merits review by the Australian Competition Tribunal (ACT). Under Part IIIA, the Tribunal has the power to affirm, set aside or vary the decision of the Minister in relation to service declarations made upon the recommendation of the NCC. Under Part XIC the ACCC is not constrained by the threat of an appeal. Part XIC service declarations made by the ACCC are *not* subject to a full merits review and can only be appealed to the Federal Court on administrative grounds.

The ACT (including its predecessor, the Trade Practices Tribunal ("TPT")) has previously acted as a significant constraint on the discretion of the ACCC (and the former TPC) in the context of authorisations of Part IV conduct. Whilst the ACT (and the former TPT) has a strong history of independence, and has brought added rigour to the assessment of significant decisions under Part IV of the Act, in recent times it has struggled to manage an increasing workload.

While a full merits review of declaration decisions is likely to reduce the timeliness of the declaration process, Telstra submits that there is an important trade-off between speed and accuracy of regulatory decisions. Any benefits that may have accrued to the industry by avoiding a six to twelve month merits review process are likely to be outweighed by the benefits of ensuring that the declaration power is constrained to those services that Parliament (and economic analysis) would suggest are most applicable for regulatory intervention. In addition, concerns regarding delay can be addressed by providing the ACT with greater resources.

Sunset clauses

A further constraint on regulatory over-reach included in Part IIIA is a sunset clause. Part IIIA declarations must include an end date (usually limited to three years) after which a review is required. Under Part XIC, there is no requirement for a declaration, once made, to be reviewed after a given period of time has elapsed or after a new service has been declared. The ACCC is simply afforded a revocation power that may be used at its discretion following a further public inquiry or after a recommendation from the TAF.

Sunset clauses have the distinct advantage of increasing industry certainty, allowing industry participants to more effectively plan their build/buy strategies. Moreover, sunset clauses help ameliorate the infant industry problems associated with declaration. If it is accepted that declaration is required to facilitate resale entry as a prelude to facilities-based entry, a sunset clause will help ensure that this handout to entrants is strictly time delimited. The lack of a sunset clause in Part XIC also means that if an erroneous declaration has been made, the costs arising from this error may continue to be incurred for extensive periods. In addition, the absence of a sunset clause increases the likelihood that new error costs arising after the declaration will go undetected.

This problem with the declaration process is illustrated by the ACCC's local service declaration. Despite there being a substitute service available (ie local PSTN originating terminating access), local call resale remains declared. Even though the unconditioned local loop service will be

available to access seekers later this month, there is no requirement on the ACCC to revise the declaration. To date the local call resale service remains declared. An exemption inquiry is underway for CBD areas, but this only highlights the problems with the exemption process. A decision to review is made by the ACCC and the onus of proof is on the access seekers to show cause why exemption should occur. In short, the discretion remains solely with the regulator.

3.4 Determinations

Upon declaration the terms and conditions of access are, in the first instance, to be determined through commercial negotiation. Failing agreement, the terms and conditions of access are to be determined either through the acceptance by the ACCC of an 'undertaking' given by the access provider; or as a result of an ACCC binding arbitration process.

When assessing an undertaking or when arbitrating an access dispute, the ACCC is required to have regard to the following matters:

- Whether the terms and conditions promote the long-term interests of end-users of carriage services or of services supplied by means of carriage services;
- The legitimate business interests of the carrier or carriage service provider concerned, and the carrier's or provider's investment in facilities used to supply the declared service concerned;
- The interests of persons who have rights to use the declared service concerned;
- The direct costs of providing access to the declared service concerned;
- The operational and technical requirements necessary for the safe and reliable operation of a carriage service, a telecommunications network or a facility; and
- The economically efficient operation of a carriage service, a telecommunications network or a facility.

The experience to date with both undertakings and arbitrations suggests that neither of these approaches has been successful in promoting the long term interests of end-users.

Undertakings

The only two price-related access undertakings lodged with the ACCC have been by Telstra for access to domestic PSTN originating and terminating access. This has proved to be an enormously costly and time-consuming task for Telstra, the ACCC and other interested parties involved in the assessment process. The Commission took nearly two years to assess Telstra's first PSTN undertaking and 10 months to assess the revised undertaking. In fact, by the time the Commission released its final assessment of Telstra's first PSTN undertaking, the price terms and conditions had already lapsed. Similarly, for the second PSTN undertaking the first year of proposed charges had lapsed by the time the Commission finalised its assessment.

The major contributing factor to this long assessment period is the importance the Commission appears to place on TSLRIC as an appropriate benchmark for setting access prices. After nearly 3 years of TSLRIC modelling, the ACCC has produced interconnect charges that are unreasonably low by any standard. As shown in Figure 14 (in Section 1), the ACCC's application of TSLRIC has produced interconnect charges below those charged by BT – the lowest interconnection charge worldwide. Despite the cost of service being clearly higher in Australia than comparison

countries[46], the ACCC has proposed an interconnect charge that is 30 percent below the average interconnect charges in comparison countries (ie countries with cost-based interconnect charges).

However, even putting the practical and implementation issues aside, Telstra has serious concerns with the concept of TSLRIC. If the access regime is designed to maximise the long-term interests of end users then competitors must be provided with a price signal that will encourage efficient investment both by entrants and the incumbent. The incumbent network should not be priced too high to encourage inefficient bypass nor too low to discourage efficient investment. The efficient cost of building and operating the access provider's actual network is most likely to send this efficient build/buy signal. In contrast, TSLRIC, if calculated correctly represents the costs of efficient bypass. If the incumbent facilities are priced at the cost of the most efficient alternative, efficient bypass is unlikely to occur. All TSLRIC has done is mark down the returns on the incumbent's assets to the level that would be expected by the most efficient operator, but is unlikely to induce entry. In effect, access seekers (and consumers) get the price of the most efficient network but not the network itself.

Telstra notes that these concerns are reflected in a recent US appeal court decision.[47] This case concerned the legitimacy of the application of the Total Element Long Run Incremental Cost ("**TELRIC**") standard (a variant of TSLRIC) by the US Federal Communications Commission ("**FCC**"). The US Court of Appeal rejected the US FCC's ruling that TELRIC be used by US State Commissions to determine what Incumbent Local Exchange Carriers ("**ILEC's**") can charge Competing Local Exchange Carriers ("**CLEC's**") for interconnection and access to unbundled network elements.

The basis for the Court's finding was that it is the cost to the ILEC of providing the *actual* facilities and equipment to be provided to an access seeker and not some state of the art, most efficient, optimised technology and configuration which should be the basis for any determination as to access prices. The Court noted that in developing the legislative framework for the regulatory setting of prices for access to telecommunications services, US Congress was "dealing with reality, not fantasizing about what might be".[48] The Court remanded the relevant rule back to the FCC with the FCC to determine a new standard for compensating access providers which should determine the "actual" costs of providing the access together with a permitted reasonable profit.[49]

Finally, experience to date raises serious doubt over the fundamental purpose of access undertakings. The principle underlying the undertaking process is to avoid the costly and time-consuming bilateral arbitrations between the access provider and each access seeker. The undertaking sets market-wide terms and conditions for access, which can be used to settle disputes when commercial negotiation fails. However, in its final report on Telstra's PSTN Undertaking the ACCC sets out the level of access prices that it believes to be efficient, but states that in arbitrations this does not mean that each service provider will receive the same price, the actual price will depend on the circumstances of each case, such as traffic profile. The fact that the ACCC is positioned to consider the individual circumstances of each access seeker raises serious doubts over whether the ACCC would ever find an undertaking, which necessarily contains generic terms

---

46 PC 2000, Population Distribution and Telecommunication Costs, Staff Research Paper.

47 See *Iowa Utilities Board, et al. v Federal Communications Commission and United States of America* No. 96-3321 (8th Circuit, 18 July 2000).

48 *Iowa Utilities Board, et al. v Federal Communications Commission and United States of America* No. 96-3321 (8th Circuit, 18 July 2000) at page 8.

49 *Iowa Utilities Board, et al. v Federal Communications Commission and United States of America* No. 96-3321 (8th Circuit, 18 July 2000) at page 14.

and conditions, acceptable. As the ACCC itself notes in its report "in accepting an undertaking the Commission is limiting its flexibility in the context of arbitrating access disputes[50]" which appears to be something that the ACCC is unwilling to do.

Arbitrations

A substantial number of arbitrations have been lodged for determination by the ACCC. Telstra estimates that a total of 43 arbitrations have been lodged with the ACCC since July 1998 with an upsurge of arbitrations lodged since amendments to Part XIC of the Act came into effect in 1999 (see Box 1 below). In Telstra's view, these amendments have greatly increased access seekers' incentives to arbitrate, because seeking arbitrated access has become a no lose game.

Box 1: The 1999 amendments to Part XIC

- Allowed the ACCC to make interim arbitration determinations which:
  - Are not reviewable by the ACT;
  - Are binding upon the parties until a final determination is made by the ACCC; and
  - Do not require the ACCC to not take into account the LTIE criteria;
- Prevent a party that wishes to challenge a final arbitration from 'staying' the effect of the arbitration when appealing to the ACT or on administrative law grounds to the Federal Court; and.
- Allows the ACCC to backdate the effect of its access determinations to the time of the dispute.

It is reasonable to infer from this upsurge that the 1999 amendments increased incentives for access seekers to seek arbitrated outcomes. One important implication of this upsurge is that the resources of the ACCC have been stretched. However, a more fundamental concern is that industry resources appear to have been diverted away from market based solutions towards regulated (ACCC) solutions, which necessarily increase the scope for regulatory error, and add to uncertainty and delay. While Telstra may be accused of contributing to that delay, it is important to note that many of the longer running arbitrations do not involve Telstra. For example, the ACCC is still yet to decide: disputes lodged by AAPT in June 1999 against Optus in relation to domestic PSTN originating and terminating access; and further disputes lodged by AAPT in July 1999 against Optus in relation to GSM originating and terminating access.

Finally, 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.

---

50 ACCC 2000, A Report on the Assessment of Telstra's Undertaking for the Domestic PSTN Originating and Terminating Access Services, July.

4 Telstra's responses to specific questions in Productivity Commission Issues Paper

4.1 Part XIC of the Act

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

Telstra does not believe that there is any policy justification for the differing criteria for declaring services under Part IIIA and Part XIC of the Act. Telstra's detailed reasons are provided in Section 3.3

2. *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?*

Telstra accepts that some services require access regulation; i.e., where essential inputs are characterised by natural monopoly properties. It is, however, highly undesirable that Part XIC always overhangs new investment in infrastructure, providing no safe harbours. It also intrudes into convergent markets, which is a matter of increasing concern.

Furthermore, the combined effect of the 1997 regime (with the 1999 amendments) and the failure of the ACCC's access pricing regime, frustrates commercial negotiation. Access regimes should promote resolution of disputes without recourse to arbitration; the present regime operates in the other direction.

Telstra acknowledges that there are some areas where regulatory distortions arise, where carriers may be held to ransom.[51] In these circumstances, an exceptional legislative power may be required without drawing each and every interconnection/access issue into the regulatory orbit in the process.

Telstra strongly supports the concept of industry self-regulation that was meant to underpin the current regulatory regime. Telstra believes that ACIF will have an increasingly significant role as time goes on. In Telstra's view, moreover, more thought should be given to how to support ACIF's role; it was clearly the intention of the 1997 legislation that there be primacy given to the role of industry self regulation. Telstra's view is that the work of the TAF is, in some respects, complete; however, it still has an important role in providing industry with an opportunity to discuss and debate the terms and conditions of access to new (or modified) services.

Telstra's major concern in respect of the operation of such industry bodies is the propensity of regulators to intervene in, and potentially affect the outcomes of, their deliberations. Both the

---

[51] This situation has arisen in the context of termination on smaller carriers' networks when competitive responses are not allowed. In particular, when such networks terminate traffic that originates on Telstra's network, Telstra must make a terminating access payment to that other carrier. As discussed in section 1.5, the majority of traffic terminated on smaller carriers' networks is currently Internet traffic, that is local calls bound for internet service providers ("**ISPs**"). Given that Telstra's local call charges are subject to price-cap regulation, it is possible (and has indeed been the case both in Australia and overseas) that smaller carriers can increase the termination charges without Telstra being able to increase its local call charges accordingly, to induce the appropriate demand response. This problem has been recognised both by other carriers' expert economists and the ACCC's economic consultants who described this situation suitably as a "money pump: see S.King, Telecommunications Round-Table, Discussion on Fixed Line Service, Melbourne, Friday 3rd March 2000.

Australian Communications Authority ("**ACA**") and the ACCC have seen fit to involve themselves in the deliberations of these industry bodies; and while this is not objectionable *per se*, the regulators often stimulate dispute rather than encourage debate and resolution of issues. Recently, for example, the ACCC raised its concerns about how access seekers would gain approval from local government bodies if access seekers were required to deploy their services from RIMs/CMUXs (these are typically located closer to end-users than traditional telephone exchanges). To do this, the ACCC wrote to Telstra (copying the correspondence to the TAF), asking Telstra, *inter alia*, whether Telstra was prepared to develop a set of industry principles to deal with the issues. Prior to this correspondence, the issue was not under discussion in the TAF but quickly became a point of disagreement and is still under debate in the TAF, for no obvious reason other than that the ACCC chose to raise it as an issue.

3. *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 ACCC has tended to adopt the standard competition policy approach to market definition in its declaration decisions. Markets are defined in product, geographical or functional terms based upon the degree of substitution observable across these dimensions. Importantly, under Part XIC, market definition plays a very limited role in determining whether or not a service is declared. Moreover, the focus of Part XIC is on telecommunications markets, thus allowing very little scope (or incentive) for the ACCC to view competition in the context of broader, converging or competing technologies. Under Part IIIA, in contrast, a market for the service at issue is defined as part of the process of determining whether or not that service is, generally speaking, a bottleneck. Under Part XIC, the ACCC can determine that a service is part of a larger market (i.e. there are competitive substitutes for this service) and yet still declare the service on the basis that it is in the long-term interests of end users to do so.

The clearest example of this situation is the analogue Pay TV decision. In that decision, the ACCC found the service at issue – an analogue-specific subscription television service limited to line links – to be part of a larger wholesale market for the delivery of pay TV services that includes cable, satellite and MDS. The ACCC therefore was forced to acknowledge that declaration of the eligible service would not promote competition in this broader market, but believed that it would promote competition in downstream markets such as retail pay television.

Telstra submits that in coming to such decisions, the ACCC tends to ignore the distortions that declaration of a service operating in a competitive market will create. Access seekers are more likely to use the declared service at regulated prices, rather than the substitute services. Access providers have fewer incentives to invest in the declared service.

4. *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?*

Telstra submits that the substitution possibilities between the traditional copper network and the newer fibre and wireless networks are expanding dramatically. This is particularly noticeable in relation to broadband data services. Telstra now provides a suite of broadband services under the *Bigpond Advance* brandname that are technologically neutral. That is, a customer comes to Telstra seeking a broadband solution and Telstra provides the service across either its HFC network via a cable modem, its traditional network using an ADSL service or via satellite depending upon where the customer lives.

Mobile telephony is converging with traditional fixed line services. For example, the "Orange" personal wirefree home phone, using wireless local loop technology, acts as both a home phone and a mobile. Increasing substitution is also technically possible at the most basic service level.

Evidence from Australia and overseas indicates that an increasing number of consumers are using mobile phones as a substitute for the fixed network. At current prices, mobile phones can be a cost effective alternative for basic access services – particularly for customers that predominantly want to receive calls. Moreover, some mobile operators have recently announced plans to provide untimed mobile local services so as to more effectively compete with the fixed network offerings.

As a consequence of these developments, Telstra is firmly of the opinion that the natural monopoly components of the telecommunications network are rapidly diminishing. Ironically, as noted in section 1.5, the operation of the access regime is impeding this process by undermining the incentives for investment in the new networks.

5. What is the process for 'undeclaring' services and is it adequate?

Two distinct issues require consideration. The first issue is *exemptions* (which are available in relation to both market conduct allegations and access); and the second issue is the process for 'undeclaring' services.

Telstra does not consider that either of the exemption mechanisms is effective. Indeed, it is well accepted that the drafting of the provisions is wrong and that the provisions fail to provide any protection. The exemption mechanisms do not work because:

1) In relation to declarations:

   a) an exemption does not provide any protection against a service which is yet to be declared;

   b) as applied by the ACCC, the Long Term Interests of End-Users test does not work - it is, instead, a measure that is applied to meet the short term needs of competitors, and hence there can be no confidence that an exemption application could succeed in respect of a service that has already been declared; and.

2) In relation to either kind of exemption (market conduct or access):

   a) to apply for an exemption, the applicant must divulge commercially sensitive information; and

   b) the ACCC expressly places less evidentiary value in information it cannot test with Telstra's competitors.

Accordingly, as the investment proposal or product launch is invariably competitively sensitive, an exemption application simply cannot be made.

The limited utility of the exemption mechanism is compounded by the fact that the process for lodging an Undertakings is unworkable and ineffective. The reasons why Undertakings are ineffective are that:

1. An Undertaking can only be lodged after a service is declared (cf Part IIIA);

2. The ACCC will invariably "revise down" the terms and conditions of the Undertaking in order to pacify access seekers who expect lower prices; and

3. The appeal grounds for Undertakings are narrower than for final arbitrations; as a result, it is more sensible to challenge an arbitration than an Undertaking.

As a result, Telstra is not at this stage prepared to lodge any further Undertakings.

The process for "undeclaring" a service is similar flawed, and for the reasons outlined below. In order for a service to be 'undeclared':

- the ACCC must hold a public inquiry in relation to the proposed revocation (see section 152AO of the Act) (a public inquiry is not required for a variation that is of a minor nature); and

- the ACCC must determine whether revocation of the declared service would be in the LTIE (this requirement can be inferred from the legislation but is not explicitly stated).

The lack of any weighting in respect of the LTIE criteria makes the process of un-declaring services extremely uncertain. As is the case with declarations, the ACCC is able to pick which limb of the LTIE it will rely upon to *revoke* a declaration (with no merits review of the decision). Telstra's experience with Part XIC (see section 3.2 of this submission) suggests that the ACCC is unlikely to have regard to the investment limb of the LTIE in considering whether to un-declare a service but instead is likely to have regard only to the competition limb of the LTIE test. This bias is addressed in Part IIIA of the Act by ensuring that declarations have a limited life and expire when the nominated deadline is reached.

Another factor that is likely to cause the regulator to favour maintaining the declaration rather than revoking it would be the regulator's reluctance to upset any commercial transactions which are on foot between an access provider and an access seeker. This factor would again make revocation more difficult than if the declaration had been subject, from the outset, to an automatic expiry date.

At this stage, the ACCC has not revoked any declarations.

The ACCC has made minor variations to two declared services, which have been noted on the ACCC's public register. A digital data access service and a domestic transmission capacity service were varied on 11 November 1998. These services are currently subject to further consideration by the ACCC. The ACCC issued a discussion paper dealing with the issues in June 2000 and expects to publish a draft report setting out its preliminary findings by August 2000 before providing an opportunity for comment on the draft report and then finalising its report.

6. *What are the main benefits and costs of access regulations (including any assessment of their dollar values)?*

Telstra submits that the current access regime has facilitated service based competitive entry, but questions what effect access regulation has had on resale price competition. It also notes it has:

- dramatically undermined incentives for efficient investment in telecommunications infrastructure;

- imposed a massive administrative burden on the industry;

- already led to major costs in the short term and will result in substantial welfare losses; and

- has concentrated on serving the short term needs of competitors rather than the long term interests of end users.

7. *What impacts are the current arrangements having on the industry?*

As discussed in section 2, the current arrangements are encouraging access-based and resale based competition, where otherwise Telstra believes there would have been sustainable network

competition. Instead of overcoming the inefficiencies associated with natural monopoly, the access regime has created new ones.

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

Telstra's response to this question is contained in section 3.4 of this submission.

9. *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?*

As discussed in section 1.5, Telstra does not believe that the TSLRIC standard is appropriate for setting access prices. From an efficiency point of view, competitors ought to build their own networks when the long run costs they will incur in doing so are below those the access provider will, as a matter of fact, itself incur over the longer run. The costs that the access provider *ought* to incur, or more generally would incur if it were run with perfect foresight, are irrelevant to this calculation: the proper price signal should reflect commercial reality as it is, not as an "omniscient social planner" might choose it to be.

This is readily seen by considering competitors' build/buy choice analytically in the presence of the type of *ex post* cost optimisation effected by the ACCC. Thus, if competitors' costs prove to be higher than Telstra's, then competitors will be better off if they have chosen to 'buy' rather than to 'build'. Conversely, if Telstra's costs prove to be higher than they could be, then regulatory optimisation will ensure that the excess costs are "optimised out": making competitors no worse off from relying on Telstra's network than they would have been had they built facilities of their own. In short, optimisation, as practiced by the ACCC's approach to cost modelling, insures Telstra's competitors against suffering any harm by 'buying' rather than 'building', and hence deters competing investment. This is not an efficient outcome.

In Telstra's view, access prices need to be set with at least a greater degree of consistency with actual forward looking costs if efficient build/buy decisions are to be made by Telstra's competitors. Concerns about 'rewarding past inefficiencies' should be addressed directly with the ACCC required to identify cost-padding in the existing network rather than trying to generate a cost estimate of a hypothetical best practice network. Such an approach will not only help ensure efficient build/buy decisions are made it has the potential to drastically reduce the administrative costs associated with access price determinations. Optimising an existing network is far easier than estimating the costs of a hypothetical optimal network.

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

As detailed at length in section 1.5, Telstra submits that the current access-pricing regime distorts the incentives for efficient investment. By consistently enforcing access prices for declared services that are significantly below cost, the ACCC reduces the incentives that Telstra has to continue to invest in its network and that Telstra's competitors have to invest in alternative network infrastructure. This is most clearly evidenced by the comparative investment data. Within Australia, almost no competitor investment in local access infrastructure has occurred outside the major capital cities. Internationally, Australia is not experiencing the competitive rollout of alternative access technologies that is occurring in North America, Europe and New Zealand.

In the short-term artificially deflating access rewards access seekers. However, to the extent there are any consumer benefits from doing this, while the disincentives for efficient investment continue, the sustainability of these consumer benefits must be brought into question.

11. 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.)

Telstra submits that the use of access holidays is only a partial solution to the problems apparent in Part XIC. There are, moreover, several conceptual and practical problems with the concept of an access holiday.

Firstly, it is difficult to see why services that would be eligible for an access holiday should ever be subject to declaration in the first place. New risky technologies should not generally be considered bottleneck facilities.

Second, even *if* declaration was justified, obtaining an exemption from the operation of either Part XIB or Part XIC is an insurmountably difficult task; and the legislation would need to be amended substantially in order to facilitate such relief.

Third, the existence of a potential access holiday in relation to such technologies would be unlikely to foster investment in relation to those services. Investment in risky technologies requires investor confidence in long term returns and not short term regulatory relief. The value of any access holiday would also be undermined by the fact that Part XIC does not require the ACCC to specify an 'end date' for a declaration; i.e, the duration of the declaration is uncertain.

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

The access deficit itself does not affect the choice of access pricing model. The access pricing regime is not guided by the existence of an access deficit. Indeed, even absent the access deficit, the cost-based approach chosen by the ACCC would have still required the modelling of customer access costs for assessing the prices of the unbundled local loop service and the modelling of switching and transmission costs for assessing the price of PSTN access.

While the access deficit may not affect the choice of pricing model, it undoubtedly complicates the access pricing approach. However, it is unlikely that this complication could be avoided. Telstra recognises that the first best solution would be to eliminate the access deficit entirely or as a second best solution to have it funded from consolidated revenues. However, in reality these options are not politically practical and hence an approach is needed that shares the burden of the price control arrangements in a competitively neutral manner. To date, this has been achieved by including a contribution to the access deficit in the PSTN access charge. However, even this approach has been the focus of considerable controversy and the efficiency and equity implications of the ACCC's approach are highly questionable.

When first assessing Telstra's PSTN access charges the ACCC did note that it would be more efficient to recover the access deficit as a flagfall charge rather than on the basis of a per minute charge as the cost of access is not traffic sensitive. Telstra agrees that this approach is indeed more efficient and in submitting its second PSTN Undertaking followed the approach proposed by the ACCC and included the access deficit as a flagfall charge. However, as some access seekers have short duration interconnect calls the flagfall structure of charges increased their effective interconnect charges compared with a per minute structure of charges. On this basis the ACCC determined that it now considers the recovery of the access deficit as a flagfall charge inappropriate and proposes that half of the access deficit should be recovered in a flagfall and the other half in a per minute charge.

Telstra has also submitted to the ACCC that the principles that apply in setting the access deficit also apply to local calls. Telstra is constrained by the same regulation from charging cost-based prices for local calls as it is for basic access. In recent years the strong growth in local call durations has resulted in local call costs exceeding the price-capped local call revenue. Hence, just as there exists an access deficit, there is also a local call deficit. However, the ACCC has refused to recognise this in considering Telstra's PSTN access charges. Rather, the ACCC's approach has been to reduce the access deficit to the maximum extent possible under the price-cap regime, thereby shifting the costs of the price control arrangements from access (which is shared by all carriers) to local calls (which is borne solely by Telstra).

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

Telstra submits that such discrimination would be possible if the ACCC were to adopt a floor and ceiling test approach to access pricing rather than the current point estimate approach.

14. *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?*

Access pricing models do have the potential to accommodate peak pricing, however, the regulator has been reluctant to allow efficient peak pricing in practice. Telstra's experience to date in attempting to implement an efficient peak load pricing structure of access prices has been unsuccessful. Telstra had proposed a structure of peak and off-peak charges for PSTN access based on network load. However, the ACCC refused to accept this structure of prices and instead proposed that the peak/off-peak structure of access charges should reflect the retail structure of peak/off-peak structure. Telstra did not (and still does not) accept that the linking of wholesale and retail charges will produce efficient outcomes. As a compromise, a flat structure of access pricing was adopted.

15. *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 overwhelming majority of arbitrations concern disputes over pricing. The only other set of access issues that have arisen concern service descriptions. Recently the ACCC has tended to provide less detailed service descriptions for declared services. This has reduced the costs associated with the declaration process but has resulted in confusion and delays during access disputes. For example, the domestic PSTN originating and terminating services were defined in very comprehensive technical detail and as a result there has been little dispute over the nature of the declared service. The declared ISDN service, on the other hand, is simply defined as an ISDN service to or from 'an exchange'. As a result, there has been considerable dispute over such issues as the location of the exchange from which the service should originate and terminate. While lengthening the declaration process, it is likely to be more efficient in terms of time and cost to deal with these details during the declaration process rather than having them raised in every access dispute for the declared service.

The multiple difficulties surrounding the implementation of the unbundled local loop declaration are also likely to produce a series of access disputes over non-price terms and conditions. Significant uncertainty remains as to the rights and obligations of the access seeker and the access provider. Of particular importance is the issue of network modernisation.

The ACCC has declared the unconditioned local loop service in terms of the copper that connects the customer to a potential point of interconnection located at or associated with a customer access module. Based on Telstra's historical network architecture the unconditioned local loop service

would be between the customer and the local exchange and hence access seekers would establish their point of interconnect at Telstra's local access switch. However, Telstra's network modernisation program involves bringing optical fibre closer to the customer to improve service quality and to meet the growing demands on the PSTN. Where Telstra has already modernised its network it has deployed remote points of concentration (or Integrated Remote Integrated Modules –IRIM) between the customer and the local exchange. Copper is used to connect customers to the IRIM and fibre is used to connect the IRIM to the local exchange. Therefore, based on the modernised network architecture the unconditioned local loop service is between the customer and the IRIM. The access seeker will need to build a point of interconnect at the IRIM or purchase a transit wholesale service from Telstra.

This raises a number of difficult issues as to the rights and responsibilities of the access seeker and the access provider. For example, when Telstra upgrades its network pushing fibre closer to the customer, it will have a direct impact on the unconditioned local loop service available to access seekers. An access seeker may take up a customer line using the declared local loop service based on Telstra's historic network architecture. When Telstra seeks to upgrade that part of its PSTN, the access seeker must either move its equipment closer to the customer or use a transit wholesale service to carry traffic to the IRIM. This imposes real costs on the access seeker, but to give it rights of veto over Telstra's network modernisation program would seriously undermine its rights as network owner and may well lead to significant economic inefficiencies if investment decisions are distorted.[52]

4.2 Part XIB of the Act

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

Telstra submits that there should not be a second route. Telstra supports the Hilmer Committee's recommendation for general competition laws applying to all industries and notes that the Government expressly contemplated that Part XIB was a short term arrangement only and would at some stage be repealed in line with this agenda. For the reasons provided in section 2 of this submission, Telstra submits that Part XIB should now be repealed.

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

Telstra submits that not only have these provisions been unjustified and unnecessary, they have also caused significant damage to the competitive process. For example, in 1997, Telstra explored the possibility with the ACCC of introducing innovative pricing that was not based on traditional time-based charging and spanned several product sets. However, problems in obtain pre-release clearance created significant delays in getting the pricing to market and resulted in the watering down of the project. More generally, the provisions have acted to discourage much normal commercial pro-competitive activity, innovation and investment, as discussed in more detail in Section 2 of Telstra's submission.

Furthermore, Telstra is frequently accused of anti-competitive behaviour resulting from the conduct of others (such as the switchports case, cited in section 3) and yet Telstra is itself unable to obtain a remedy from the ACCC when other firms engage in anticompetitive conduct. For example, for several years, Optus has failed to provide Telstra with mobile origin location

---

[52] To overcome this problem, Telstra proposed the declaration of a managed bitstream service. This would address the difficulties raised by the changing network architecture and still provide access seekers with the ability to provide xDSL services to consumers. However, the ACCC rejected this proposal.

information ("**MOLI**"). MOLI is necessary to identify the location of a caller from a mobile telephone; it thus ensures that a product or service can be despatched from a location that is close to the caller.[53] Optus' failure to provide MOLI has caused Telstra massive inconvenience. Telstra has about 100 customers who are seriously affected by Optus not providing MOLI and many more who are greatly inconvenienced by it. Optus has just ignored Telstra's legitimate complaints about Optus's failure to provide MOLI and the ACCC refuses to do anything about it as well. This asymmetric application of regulation is not only extremely costly for Telstra, it deprives the industry of a process to deal with multi-carrier issues.

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

The operation of Part XIB has the very real potential to distort investment decisions. For example, the Internet Peering Competition notice appears to have altered market behaviour in important respects. There are, in particular, strong signs that competing IAPs have restricted their investment in transport outside of the main Eastern metropolitan areas, relying instead on the Telstra backbone. The Internet consultancy company, www.consult, produces periodic surveys of Internet access in Australia.[54]

These surveys highlight the limited role of non-Telstra providers of network capacity in areas other than Sydney and Melbourne. Importantly, the October 1999, survey found that "Telstra has strengthened its overall position as a primary bandwidth provider".[55] It appears the Commission's actions have tended to lessen, rather than enhance, diversity and competition in the provision of Internet backbone services.

At a more general level, Part XIB operates as a disincentive for Telstra to invest in new or innovative technologies. For example, Telstra's plans to "broadband the nation" were substantially delayed because it was not possible for Telstra to predict how the ACCC would respond to Telstra's proposed broadband roll-out plans. The regulatory risks were taken into account in the roll-out plans, the capital for which was scaled back accordingly.

4. *Are competition notices an appropriate mechanism for initiating action? Are the criteria used for deciding whether to initiate a competition notice appropriate?*

Telstra submits that a competition notice is an entirely unnecessary and inappropriate mechanism for initiating action.

To the extent to which competition notices were designed to provide a more rapid response to suspected anti-competitive conduct in the telecommunications industry they were unnecessary, as the ACCC and third parties have the ability under Part VI of the Act to seek interim and final injunctions to restrain conduct suspected of contravening Part IV of the Act.

A competition notice is an inappropriate mechanism as it represents the substitution of largely unaccountable administrative discretion in place of the more rigorous and independent judgment of a court. Further, the consequences for a notice recipient are much more serious than if action against the firm were initiated under Part IV of the Act. As a result, competition notices have a much greater potential to discourage legitimate pro-competitive conduct.

---

53 For example, MOLI may be necessary to identify the location of a caller to a nation-wide 13xx pizza store number, so that the pizza can be despatched from a location that is close as possible to the caller)

54 See for example www.consult *7th IAP Report: Internet Access in Australia* (November 1998), especially at pages 18 to 21.

55 See www.consult *9th IAP Report: Internet Access in Australia* (October 1999), page 19.

The criteria the ACCC applies in determining whether to issue a competition notice are also inappropriate. The ACCC needs only to have a "reason to believe" a contravention of the competition rule has occurred or is occurring before it may issue a competition notice.

Under the "reason to believe" standard, the ACCC is merely required to act in good faith and believe on reasonable grounds that there may be a contravention of the competition rule. The ACCC need not be satisfied that there is an actual contravention of the Act and is not required to investigate matters in detail. The experience with the issue of section 155 notices is that the "reason to believe" threshold is very low indeed.

In addition, Telstra submits that the "reason to believe" standard:

- Raises questions of procedural fairness;

- Provides service providers with little certainty as to the circumstances in which the ACCC would be entitled to issue a competition notice; and

- Will result in much potentially beneficial and pro-competitive behaviour being falsely condemned or falsely discouraged by the fear of threatened or issued notices.

Telstra submits that sound decisions cannot be taken without ascertaining the relevant facts, hearing from all interested parties and carefully evaluating the evidence and submissions. Indeed, in the area of competition law, a thorough examination of the facts and circumstances in each case is essential in order to determine if conduct is anti-competitive. This is the essence of good regulatory policy and should not be watered down for expediency.

Sound regulatory policy also requires a high level of certainty from the ACCC in how its powers will be exercised. Telstra submits that regulatory decisions which so significantly affect the legal rights and obligations of service providers, and which can have very serious impacts on important markets and on the long-term interests of Australian consumers, should be made on a well informed basis.

Telstra further submits that the degree to which the ACCC should be "satisfied" that there has been a breach of the competition rule should be proportional to the consequences of its decision. In light of the very serious consequences of a competition notice for the notice recipient, Telstra submits that the ACCC should be required to be at least "affirmatively satisfied" that the alleged conduct is in fact a contravention of Part XIB. This would be appropriate to reflect the fact that the Part XIB regime has, in effect, substituted administrative fiat for judicial determination of allegations of illegal conduct.

5. *Have Part A competition 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?*

There is no evidence yet on whether Part A notices have resulted in a speedier process as the ACCC has not yet issued a Part A notice.

However the looser requirements for the issue of a Part A notice *have* increased the uncertainty for market participants as to whether the ACCC will issue a competition notice, and increased the risks that the ACCC will issue notices without fully specifying the conduct of concern, thereby further discouraging legitimate pro-competitive conduct and incentives for investment.

Indeed, Telstra submits that the amendments that were made to Part XIB in 1999 in an attempt to address perceived (but not actual) problems of delay were unwarranted and now pose even greater risks for economic performance

6. There have been very few competition notices issued - how is this to be interpreted?

There are two main reasons why few competition notices have been issued:

- First, Telstra, as the firm most likely to be the subject of competition notices, has acted as a responsible corporate citizen and has sought to comply with the competition rule during the period that Part XIB has been in place. It is not surprising; therefore, that few competition notices have been issued in that period. Telstra notes that it has never been found to have contravened the competition rule, despite the several notices that have been issued;

- Second, to the extent that, since July 1997, there has been a risk that the ACCC would issue competition notices in regard to conduct which Telstra considers not to be a contravention of the competition rule, Telstra is always conscious in its commercial decision-making process of the risk of regulatory error and tends to err heavily on the side of caution, foregoing much legitimate pro-competitive conduct, in attempts to avoid any circumstance which may raise ACCC concerns.

7. *Are there any important differences between Part IV and Part XIB and what impact do those differences have?*

The Part XIB regime, and the subsequent amendments to that regime, introduced a range of provisions aimed at providing the mechanism for a more rapid and effective response to suspected anti-competitive conduct in the telecommunications industry, namely:

- Competition notices (1997);

- The effects test (1997);

- Higher maximum penalties (1997);

- An amended effects test (1999);

- A "reason to believe" standard for the issue of competition notices (1999);

- Loose formal requirements for the issue of (Part A) competition notices (1999); and

- Limitations on normal procedural safeguards, including the removal of the ability to stay the operation of a competition notice (1999); and

- Advisory notices (1999).

It is Telstra's experience that these measures have been applied entirely asymmetrically. Furthermore, Telstra submits that not only have these measures been unjustified and unnecessary, they have also caused - and unless Part XIB is wound back, will continue to cause - significant costs which should not be overlooked. In particular, the measures have resulted and will continue to result in:

- The discouragement of normal commercial pro-competitive activity, innovation and investment, particularly given:
    - The very serious consequences for a recipient of a competition notice (whether there has in fact been a contravention of the competition rule or the recipient is innocent of any alleged anti-competitive conduct);
    - The greater uncertainty for business, both as to what constitutes a contravention of the competition rule, and how the ACCC will interpret the competition rule and whether the ACCC will intervene;

- The increased risk of incorrect decisions by the ACCC under Part XIB; and
- the lack of adequate mechanisms for both procedural and merits review of ACCC decisions;

- Inefficient and uncommercial outcomes;
- Increased regulatory gaming and the attendant wastage of resources;
- Prejudice to commercial negotiations; and
- Risks that due process may not be observed.

The costs of these effects are obviously hard to measure, but are likely to be very substantial, particularly over the medium to long term in a significant and dynamic industry such as telecommunications. Each is discussed in more detail in Section 3 of Telstra's submission.

Attachment A: Regulatory Obligations imposed on Telstra

Obligation	Description
Competition Regulation	
Competition rule	In addition to the general requirements of trade practices law, a carrier or carriage service provider must not engage in anti-competitive conduct in breach of the competition rule (see section 4 below)
Information gathering powers	The ACCC may seek information from carriers about charges for products and services subject to a right of appeal to the ACT. The ACCC may publish this information if satisfied that there would be a net public benefit in doing so and has a further general power to obtain information in relation to designated telecommunications matters.
Record-keeping rules	The ACCC is developing new accounting rules which require the reporting of non-public cost and revenue information
Retail Price Controls	
Retail price caps	Telstra faces a CPI-5.5% cap on a basket of 8 services. It cannot increase prices beyond annual increases in CPI for a basket of line rentals and local calls and a basket of connection services. A sub-cap of CPI - 1% applies to a basket of services for residential customers. Revenue-weights for services in this basket are set at the average for the bottom 50% of residential customers by bill size. Line rentals for the bottom 10% of residential customers must not increase by more than CPI in one year unless the ACCC is satisfied that products or arrangements are in place to ensure that these customers bills do not, on average, increase by more than CPI.
Local call charges	Carriers are required to provide untimed local calls to residential and charity customers for all local calls and business customers for local voice calls. Telstra must not charge more than A$0.40 for untimed local calls from payphones or more than A$0.25 for any other untimed local calls. Until 30 June 2001, Telstra must also ensure that the average price for untimed local calls provided in non- metropolitan areas in a fiscal year does not exceed the average price levied in metropolitan areas in the previous fiscal year
Directory assistance charges	Telstra cannot impose or alter a charge for our directory assistance services without the approval of the Communications Minister.
Access	
Declaration / Determination	The ACCC has broad powers to determine those services to which competitors will have access and the terms and conditions under which this access is provided (see section 3 below).
Standard access obligations	Unless exempted by the ACCC, carriers who supply declared services to themselves or anyone else must comply with “standard access obligations”.

Carrier Licences

General licences

Carrier licences are issued by the ACA. The annual charge for a carrier licence is currently A$10,000 plus a pro-rata revenue-based contribution to industry regulatory costs. All carriers must, as a condition of their carrier licence, comply with the Telecommunications Act, the Telecommunications (Consumer Protection and Service Standards) Act and the standard access obligations. Any breach of licence conditions is subject to a penalty of up to A$10 million.

Telstra licence conditions

As a condition of its licence, Telstra must provide operator and directory assistance services;

- annually produce, publish and provide an alphabetical telephone directory;
- establish and maintain an integrated public number database and provide access to the database to all carriage service providers;
- ensure reductions in connection and annual charges for certain basic telecommunications services of at least specified amounts if a customer does not rent a handset from us for use with that service;
- have in place and report against an approved industry development plan and comply with the plan to the extent it relates to research and development;
- provide resale (for a limited time) of, and / or roaming on, our AMPS service to the operators of proposed new digital mobile networks on commercially negotiated or arbitrated terms and conditions; and
- extend an equivalent mobile service to those areas previously served by AMPS, when AMPS is phased- out.

Number portability

Fixed number portability

Full number portability is mandated. The terms and conditions can be arbitrated

Mobile number portability

The ACCC has issued a direction to the ACA to mandate the implementation of mobile number portability. Mobile number portability will be required as of September 2001. The ACCC has also issued draft pricing principles relating to mobile number portability

Preselection

Currently, carriage service providers must provide for the preselection of one carriage service provider for long distance services

AMPS network closure

Telstra has been required to shut down its Analogue mobile network and replace it with a digital network providing equivalent geographic coverage.

Interception

Carriers are required by law to cooperate with law enforcement agencies. They must, unless exempted by the Communications Minister, ensure that telecommunications services passing over their networks can be intercepted by agencies who hold an interception warrant.

Universal service obligation

Telstra is currently the sole national universal service provider. This means that it must ensure that standard telephone services, payphones and any additional carriage services that might be prescribed by regulation are reasonably accessible to all people in Australia on an equitable basis. Telstra is also the “digital data service provider” requiring to ensure e that all people in Australia have reasonable access on an equitable basis to a 64 kilobits per second ISDN service or a broadly comparable satellite service. Originally the costs of the USO were to shared among all carriers. However, in accordance with the Telecommunications Laws Amendment (Universal Service Cap) Act 1999, Telstra is required to bear almost all of the costs

Customer service guarantees

At the direction of the Communications Minister, the ACA has made mandatory standards for carriage service providers in relation to the connection and restoration of basic telephone services and enhanced call handling features. These customer service standards came into effect on 1 January 1998. The connection and restoration timeframes were tightened on 1 July 2000.

Customer service guarantees

In July 1999, the ACA made a determination which from March 2000 requires carriage service providers to provide customers with concise summaries of the terms and conditions on which customers acquire their goods and services.

Radio Spectrum Licencing

Spectrum licences are issued by ACA to radio network operators subject to provisions of the Radiocommunications Act 1992 that allow for a maximum fixed licence period of 15 years with no mechanism for renewal. Given the staged network rollouts and progressive enhancement of capacity & functional service performance over time, the concept of a commercial lifetime of telecommunications infrastructure has little meaning, and the fixed term results in a disincentive for ongoing investment in the latter part of the licence period.

Radio Spectrum Allocation Rules

Key segments of the radio spectrum are increasingly allocated by ACA through competitive price-based mechanisms in accordance with the Radiocommunications Act 1992, but subject to specific auction competition rules beyond the provisions of the TPA, that apply only to participation in the respective auction. These rules have been substantially aimed at constraining Telstra, although a few other carriers have been included from time-to-time, and have imposed unnecessary & discriminatory costs on a range of customer services – most notably on the development & expansion of critical radio infrastructure serving regional & rural communities (eg. 1.8GHz and 3.4GHz).

In a recent case addressing allocation of 3.4GHz band, Telstra was explicitly excluded from bidding not only in state capital cities, but in the crucial regional urban centres (Albury, Bendigo, Cairns, Rockhampton, etc) that ordinarily form the nucleii of key regional networks. Without these centres, network configuration & deployment becomes problematic, increasing costs and undermining commercial viability.

Earlier limits on Telstra ability to competitively bid for 1.8GHz spectrum blocked efforts to protect key regional radio links serving rural telephone exchanges, despite indications that new carriers usually target the more lucrative capital city areas and have little interest in deploying infrastructure in regional areas..

There is increasing concern that similar limits may be placed on Telstra in forthcoming spectrum auctions (eg. 800MHz), simply to further encourage new competitors and without due consideration of the wider implications for regional services.

Content regulation

From February 2000, carriage service providers will be prohibited from allowing telephone sex service providers to supply telephone sex services to customers with some limited exceptions. Amendments to the Broadcasting Services Act 1992 have also introduced a scheme for regulating unsuitable content on the Internet.

Attachment B: ACCC's Powers Under Part XIB of TPA

POWER AND RELEVANT SECTIONS	COMMENTS
Competition Rule (section 151AK) A carrier or carriage service provider (CSP) must not engage in anti-competitive conduct **Anti-competitive conduct** (section 151AJ) A carrier or CSP engages in "anti-competitive conduct" if it - • engages in conduct in contravention of section 45, 45B, 46, 47 or 48 where the conduct relates to a telecommunications market; or • takes advantage of a substantial degree of power in a telecommunications market with the effect, or likely effect, of substantially lessening competition in that or any other telecommunications market. In the 1999 amendments, the definition of anti-competitive conduct was extended to also apply where a carrier or CSP took advantage of a substantial degree of power in a telecommunications market, "and engages in other conduct on one or more occasions, with the combined effect, or likely combined effect, of substantially lessening competition in that or any other telecommunications market".	The 1999 amendment is vague, uncertain and unjustified. What does "engages in other conduct on one or more occasions" mean? It does not have to be conduct which involves a taking advantage of a substantial degree of market power, so that it could be any conduct at large (including conduct which, on its own, is perfectly lawful and commercially rational). The provision now applies, therefore, to a taking advantage of a substantial degree of market power even when such conduct does not substantially lessen competition nor is likely to substantially lessen competition, provided there is some other conduct (either current or in the past) which would have the combined effect or likely effect of substantially lessening competition. This is bad law.
Part A Competition Notice (section 151AKA) The Commission can issue a Part A competition notice stating that a specified carrier or CSP has engaged, or is engaging, in either: (i) a specified instance of	The threshold is very low as the Commission can issue a Part A competition notice merely on a "reason to believe" that the carrier or CSP has engaged, or is engaging, in that instance of anti-competitive conduct or in one instance of anti-competitive conduct of a particular kind (see section 151AKA(7) and

POWER AND RELEVANT SECTIONS	COMMENTS
anti-competitive conduct; or (ii) at least one instance of anti-competitive conduct of a kind described in the notice. Under the latter form of a Part A notice, the Commission is not required to specify any instance of anti-competitive conduct, that is, the Commission need only specify the "kind of anti-competitive conduct".	(8)). Further, the ability of the Commission to provide a level of generality and avoid having to specify a particular instance of anti-competitive conduct makes it even more difficult for the recipient of the notice to assess the strength of the allegation being made against it and the changes in its conduct that might be required to avoid the consequences of the notice. These amendments are contrary to basic principles of procedural fairness and natural justice and also are not justified by experience since 1997.
Part B Competition Notice (section 151AL) The Commission may issue a Part B competition notice stating that a specified carrier or CSP has contravened or is contravening the competition rule and setting out particulars of that contravention.	Pursuant to the 1999 amendments, the threshold for issuing a Part B competition notice (like a Part A notice) is merely a "reason to believe". A Part B competition notice may be issued even after relevant proceedings have been instituted and is to be prima facie evidence of the matters in the notice (see sections 151AL(3), (4) and 151AN(1)). As noted above in respect of Part A competition notice, these amendments are lacking in procedural fairness and natural justice principles which should be the foundations for all laws.
Limitation on Right to Challenge a Decision to Issue a Competition Notice (Section 151AQA) This section prevents a review of a decision to issue a competition notice under the Administrative Decisions (Judicial Review) Act 1977 or the grant of an order staying or otherwise affecting the operation or implementation of a decision to issue a competition notice.	These 1999 amendments attempt to protect the Commission from appropriate administrative or legal review of a decision to issue a competition notice. The Commission now has very broad discretions in the issue of competition notices, and those notices can have enormous commercial and legal consequences, yet a carrier or CSP which is subject to a competition notice has very limited rights to challenge the Commission's decision. As has been seen in the Commercial Churn case, any resolution by the Court of whether or not certain conduct, the subject of a competition notice, in fact contravenes the Act, will normally take a long period of time (probably in the order of 1 to 2 years). In the interim, Part XIB seeks to ensure that the Commission's view, based upon a mere "reason to believe" prevails and cannot be challenged. There needs to be greater checks and balances in the process to ensure that the

POWER AND RELEVANT SECTIONS	COMMENTS
	Commission's view is properly based and the consequences of a notice are justified relative to the administrative convenience of avoiding a legal review of the Commission's decision.
Advisory Notices (section 151AQB) The Commission can issue advisory notices advising a carrier or CSP of the action it should take to ensure that it does not engage in the kind of conduct dealt with in a Part A competition notice.	This provision would not be needed if the Commission were obliged to particularise the conduct on which its Part A Competition Notice is based. Slackness in this regard, is not appropriately remedied by further discretionary powers for the Commission to advise a commercial company as to how it should run its business.
Exemption Orders (sections 151AS - 151BI) The Commission may grant an "exemption order" upon a written application.	The procedure for obtaining an exemption order is similar to the procedure for obtaining an authorisation. As with an application for authorisation, the public nature of the process and the public benefit test discourage such applications by making them lengthy processes open to competitor interference.
Tariff Filing Directions (section 151BK) If the Commission is satisfied that a person has a substantial degree of power in a telecommunications market, the Commission may give the person a written direction to file a tariff.	Tariff filing directions can impose hurdles for a carrier amending its charges quickly in response to competition or other market circumstances. Also, as tariff filing directions are kept on a register open to the public and the Commission has an ability, subject to a public benefit test, to provide a copy of tariff information to the public, this power can dampen competitive pricing by the subject carrier or CSP.
BCS Tariff filing by Telstra (section 151BTA) This is a special provision for Telstra to file tariffs in respect of basic carriage services.	See previous comment.
Record Keeping Rules and Disclosure Directions (section 151BU) The Commission may make rules for a carriers or CSP to keep and retain particular records.	This power can impose a significant administrative burden upon a carrier or CSP particularly if their commercial information is not readily available in the form which the Commission requires.
Enforcement Section 151BX provides for pecuniary penalties of up to - • $10 million and $1 million per day, for a breach of a the competition rule; • $10 million for each contravention of a	The potential penalties for a breach of the competition rule are very large, which makes the limitations on a party's ability to challenge a competition notice or even to know precisely what conduct is dealt with by

POWER AND RELEVANT SECTIONS	COMMENTS
tariff filing direction; and • $250,000 for a contravention of the record keeping rule or disclosure direction. Importantly, pursuant to section 151CA, the Federal Court is entitled to grant an injunction. If the Commission makes an application to the Court for an injunction, the Commission is not required to give any undertaking as to damages. The Federal Court also has power to make orders to disclose information or publish an advertisement in respect of a breach of the competition rule, and award damages to a person who brings an action for damages (see sections 151CB and 151CC).	a competition notice, all the more unfair. If the Commission is interested in speed rather than its own administrative powers, it would seek an injunction and place its evidence and arguments before a judge.
Review by Tribunal (section 151CI) An application for review may be made to the Tribunal in respect of Commission decisions to refuse to make an exemption order, to revoke an exemption order, and to make information available for inspection and purchase.	The decisions of the Commission that are subject to review by the Tribunal are quite limited, and section 151CI is more notable for what it omits than for what it provides.

Attachment C: Declared services

This attachment lists the telecommunications services that have been declared by the Commission, a brief description of the declared service, the date on which the service was declared and the method by which the service was declared.

Register of Declared Telecommunication Services by public inquiry and TAF consideration

Service	***Service Description***	***Date of declaration***	***Method of declaration***
Analogue Subscription Television Broadcast Carriage Service	A service for the carriage, by means of lines, of analogue signals used for the purposes of transmitting a subscription television service from a facility owned, controlled or operated by a carrier or carriage service provider to any point on, or in, a line link, customer cabling, or customer equipment connected to that facility.	1 September 1999	Public Inquiry initiated by ACCC
Declaration of Local telecommunication services			
Unconditioned Local Loop Service	The Unconditioned Local Loop Service is the use of unconditioned communications wire between the boundary of a telecommunications network at an end-user's premises and a point on a telecommunications network that is a potential point of interconnection located at or associated with a customer access module and located on the end-user side of the customer access module.	4 August 1999	Public Inquiry following TAF consideration (matter referred to ACCC following lack of consensus by TAF)
the Local PSTN Originating Service	The Local PSTN Originating Service is a service for the carriage of telephone calls from customer equipment at an end-user's premises to a point of interconnection, or potential point of interconnection, located at or associated with a local switch and located on the outgoing trunk side of the switch.	4 August 1999	Public Inquiry following TAF consideration
the Local PSTN Terminating Service	The Local PSTN Terminating Service is a service for the carriage of telephone calls from a point of interconnection, or a potential point of interconnection, located at or associated with a local switch and located on the incoming trunk side of the switch to customer equipment at an end-user's premises.	4 August 1999	Public Inquiry following TAF consideration
Local Carriage Service	The Local Carriage Service is a service for the carriage of telephone calls from customer equipment at an end-user's premises to separately located customer equipment of an end-user in the same	4 August 1999	Public Inquiry following TAF consideration (matter referred to ACCC following

	standard zone.		lack of consensus by TAF)
Integrated Services Digital Network Originating Service	The Integrated Services Digital Network Originating Service is a service for the carriage of certain communications, being ISDN calls, by way of an integrated services digital network from customer equipment at an end-user's premises in Australia to an exchange.	November 4, 1998	Public Inquiry following TAF consideration
Integrated Services Digital Network Terminating Service	The Integrated Services Digital Network Terminating Service is a service for the carriage of certain communications, being ISDN calls, by way of an integrated services digital network from an exchange to customer equipment at an end-user's premises in Australia.	November 4, 1998	Public Inquiry following TAF consideration
Digital Data Access Service (variation)	The Digital Data Service is a service for the carriage of certain communications, being data in digital form, between customer equipment at an end-user's premises in Australia and a point of interconnection Key variation: removal of mandatory TDCC requirement	November 4, 1998	Public Inquiry following TAF consideration
Domestic Transmission Capacity Service (variation)	The Domestic Transmission Capacity Service is a service for the carriage of certain communications from one transmission point to another transmission point via network interfaces at a designated rate on a permanent basis by means of guided and/or unguided electromagnetic energy, except communications between: - one customer transmission point and another customer transmission point; - a transmission point in Sydney and a transmission point in Melbourne; - a transmission point in Melbourne to a transmission point in Canberra; - a transmission point in Sydney and a transmission point in Canberra; and - a transmission point in a State or Territory capital city and a transmission point in another State or Territory capital city, where the communications would entail communications of the type described in one or more of paragraphs (b), (c) and (d) if the capacity was routed via a continuous cable running from Brisbane to Perth through each of the capital cities.	November 4, 1998	Public Inquiry following TAF consideration

	Key variation: (1) declaration of all routes except Melbourne – Canberra – Sydney route. (2) declaration of services with transmission rates of greater than 2 Mbps		

Deemed Services[56]

Declared services	***Service description***
Domestic PSTN originating access	An access service for the carriage of telephone (i.e. PSTN and PSTN equivalent such as voice from ISDN) calls (i.e. voice, data over the voice band) to a POI from end-customers assigned numbers from the geographic number ranges of the Australian Numbering Plan and directly connected to the Access Provider's network.
Domestic PSTN terminating access	An access service for the carriage of telephone (i.e.. PSTN and PSTN equivalent such as voice from ISDN) calls (i.e.. Voice, data over the voice band) from a POI to end-customer assigned numbers from the geographic number ranges of the Australian Numbering Plan and directly connected to the Access Provider's network.
Domestic GSM originating access	An access service for the carriage of telephone calls (i.e.. voice, data over the voice frequency band) to a POI from end-customers assigned numbers from the GSM number ranges of the Australian Numbering Plan and directly connected to the Access Provider's GSM network.
Domestic GSM terminating access	An access service for the carriage of telephone calls (i.e.. voice, data over the voice band) from a POI to B-parties assigned numbers from the GSM number ranges of the Australian Numbering Plan and directly connected to the Access Provider's network.
Domestic AMPS originating access	An access service for the carriage of telephone calls (i.e.. voice, data over the voice frequency band) to a POI from end-customers assigned numbers from the AMPS number ranges of the Australian Numbering Plan and directly connected to the Access Provider's AMPS network.
Domestic AMPS terminating access	An access service for the carriage of telephone calls (i.e.. voice, data over the voice band) from a POI to B-parties assigned numbers from the AMPS number ranges of the Australian Numbering Plan and directly connected to the Access Provider's network.
Transmission*	A service for the provision of media independent transmission capacity at 2.048 Mbit/s between Transmission Points, except for capacity on routes between Brisbane, Sydney, Canberra, Melbourne, Adelaide and Perth.
Digital data access service*	An access service for the domestic carriage of data between a digital data Interconnect Terminal Point located at the access seeker's exchange or network facility and a NTU or unimux or modem located at the customer's premises where the customer is directly connected to the access provider's network.
Conditioned local loop service	A service for the supply of media independent unswitched transmission capacity of voice band width, being a leased conditioned two-wire (twisted copper pair) analogue based service.
AMPS to GSM Diversion Service	A service whereby all calls made to a nominated AMPS Network number are diverted to a designated POI of the GSM carrier/carriage

56 Deemed services came into effect from July 1997 concurrently with the new telecommunications regulatory regime.

	service provider nominated by the former AMPS subscriber.
Broadcasting access service	An analogue service necessary for the purposes of enabling the supply of a broadcasting service by means of line links that deliver signals to end-users, and of a kind that was used for those purposes on 13 September 1996. This is an access service which provides a basic carriage and distribution access function together with other functions as requested.