APPENDIX A - Issues raised at the August Commission Inquiry Hearings

A number of issues were raised at the Commission's hearings in August that Telstra wishes to comment upon in this submission:

- the lodging of "generic" undertakings;
- posting wholesale prices; and
- factors contributing to the success of the role of the Australian Communications Industry Forum ("**ACIF**") in industry self regulation.

A1 Generic undertakings

A proposal to simplify access arrangements is to have "generic undertakings", rather than service specific undertakings as under the current regime. This is understood to be an undertaking by an access provider that relates to particular pieces of infrastructure that are used (in combination) in the provision of a number of declared services.

After considering the benefits and costs of this approach, on balance Telstra does not support generic undertakings, for the following reasons:

- Generic undertakings would be inconsistent with the existing services based declaration regime. Such undertakings would not be helpful in establishing terms and conditions (including price) for particular services as the appropriate terms and conditions for network elements do not necessarily sum to those appropriate for services. Furthermore, assessment of such undertakings in terms of their market impact, and international benchmarks, would be very difficult, if not impossible.

- Generic undertakings are not necessary, as establishing correct costing parameters for PSTN access will have clear flow through implications for other services such as Unconditioned Local Loop, Local Carriage Services and Digital Data Access Service.

While there might be seen to be some possible benefits from generic undertakings, such as consistency and transparency, these can be met under existing undertaking arrangements.

A2 Posting of wholesale prices

Telstra does not support the posting of wholesale prices, for the following reasons:

- It works against economic efficiency, which is maximised by customer specific pricing arrangements. Posting of prices would tend to lead to uniform pricing, whereby efficiency considerations require pricing to fit particular circumstances.

- It is inconsistent with primacy given commercial negotiation in the access regime. Negotiation would cease or be severely curtailed if prices were posted.

- It is at odds with competition law and practice in Australia and overseas, as it facilitates the mimicking of pricing behaviour by competing suppliers.

- The mere posting of a price does not address information asymmetry concerns, which primarily relate to underlying cost. (Besides, these concerns are not as great as made out by some industry participants, with many players having direct access to network cost characteristics from their large parent companies.)

In short, therefore, Telstra does not believe that posting of wholesale prices is supported by accepted economic principles or legal practice.

A3 ACIF Success Factors

The Productivity Commission has asked what are the factors behind ACIF's success as an industry self-governance body. Telstra believes there are two key factors behind the success:

- The subject matter addressed by ACIF, which is primarily inter-operability, where win - win solutions often prevail.
- For the issues addressed by ACIF, there is generally no regulatory fallback mechanism, so industry agreement must be reached for service provision to proceed.

This contrasts with the TAF:

- It addresses issues for which a clear regulatory mechanism, the access regime, exists as a fallback if parties cannot agree.
- The issues addressed are more likely to be of a clear win/lose commercial nature.
- Guidance from participating regulators has not always been strong, and in a number of instances could be seen as having the impact of working against agreement rather than facilitating agreement.
- Nonetheless the TAF has been useful to this point in fleshing out issues before they are addressed by the ACCC.

The implications of these observations are three-fold:

- Self-regulation has proved to be successful for technical inter-operability issues, but has clear limitations for straight commercial matters.
- In this regard, there is a clear need for a sound access regime as there is a tendency for commercial access issues to fall back on this regime rather than get resolved by industry self regulation.
- The value of regulators participating in self-regulation fora is dubious – as they do not (and can not) offer authoritative advice.

Appendix B - Issues raised in other submissions

Overview

This Appendix considers and responds to the arguments raised in submissions to the Commission made by other parties, including:

- the proposed introduction of a multi-party arbitration mechanism to telecommunications competition policy;
- certain claims by Cable and Wireless Optus ("**CWO**") regarding market power and charges in the telecommunications industry;
- the implications of convergence for regulation in the telecommunications industry;
- CWO's proposed re-introduction of a "dominance" test to telecommunications competition policy;
- the proposed introduction of ACCC powers to issue "cease and desist" orders in response to anti-competitive conduct in the telecommunications industry; and
- the proposed introduction of ACCC powers of compulsory lodgement and amendment of undertakings by telecommunications firms.

Telstra submits that the effect of these proposed changes to the regulatory regime would not best serve the interests of maintaining competition and efficiency in the Australian telecommunications market.

B1 Common ground

Before analysing how the proposals made by other parties differ from Telstra's position, some attention should be given to the ways in which other parties' submissions echo the views held by Telstra. These submissions to the Productivity Commission express concern with potential regulatory overreach in the current regulatory regime, and in great part replicate Telstra's own arguments on this topic. In particular, these submissions reinforce Telstra's view that the effect of the industry-specific rules of Parts XIB and XIC of the Act are no longer in the best interests of encouraging and increasing competition in the Australian telecommunications industry. These parties support Telstra's view that the adoption of the more general, non-industry specific principle embodied in Part IV for regulation of the telecommunications industry would be more beneficial to the industry and the economy as a whole, including consumers.

Vodafone has contended that telecommunications regulatory policy should be governed by a principle of regulatory forbearance, which it believes, "as an overarching principle, will produce optimal consumer welfare and industry development…." Furthermore, Vodafone has stated explicitly that "[t]he foundation for further regulation in Australia should be the application of general competition policy, as set out in the competition principles agreement between the state and

Commonwealth governments; in turn, drawing on the work of the Hilmer Committee."[1]

In its submissions to the Productivity Commission, CWO has expressed reservations about the encroachment of the access regime into competitive markets, thus suggesting their opposition to the current Part XIC framework. At the public hearings, CWO stated that not only has the Part XIC access regime been extended, but "it's been overreached…it's been extended, in contrast to Part IIIA, to regulate markets that we say are fundamentally competitive," namely "mobile networks…inter capital city transmission networks…and even subscription services."[2] CWO has even suggested the advisability of aligning Part XIC and Part IIIA of the TPA, stating that:

> …the Productivity Commission could look to some of the provisions in Part IIIA as guidance as to how the current regime, not in process terms but in the test declaration terms, could be sort of streamlined to ensure that future declarations applied just in particular to bottlenecks of facilities which provided significant market power.[3]

The Institute of Public Affairs ("**IPA"**) replicates these foregoing concerns about regulatory overreach. The IPA testified in the Productivity Commission Hearings that Telstra's market power (if any) would be adequately regulated under Part IV of the TPA . The IPA stated that Telstra's size alone does not cause market imperfections, "because there are many big players in this market, and there are new entrants all the time," and that Telstra does not have a "tremendous first-mover advantage in terms of innovation" that would cause concern. The IPA further stated that:

> Our broad judgment is … that the competition, the competitors and the market have developed to the point where XIB and XIC could go …[and] that the powers within part IV could cover Telstra's use of market power or abuse of market power.[4]

Quite clearly, it is the view of the IPA that the existing industry-specific provisions (Parts XIB and XIC) should be repealed, and the general provisions of the Act (Part IV) left to regulate the potential misuse of market power by carriers in the telecommunications industry.

Ericsson Australia endorsed the repeal of Parts XIB and XIC, at least with respect to mobile communications."[5]

Likewise, in its submission the Northern Territory Office of Communications, Science and Advanced Technology contended that, in applying Parts XIB and XIC, the ACCC had favoured service-based competition over competition for

1 Vodafone, transcript, Productivity Commission hearings, 14.8.00, p.42J.

2 Optus, transcript, Productivity Commission hearings, 14.8.00, p.69P.

3 Optus, transcript, Productivity Commission hearings, 14.8.00, p.75P.

4 IPA, transcript, Productivity Commission hearings, 15.8.00, 186B; 187B.

5 Ericsson Australia, public submission to Productivity Commission Inquiry, July 2000, p.4.

infrastructure. The Office expressed concern that the regime had "provided no incentive to invest in infrastructure at all [in] those areas that most need it," because:

> While this was never the intent of the legislation, this has been the practical outcome. Part XIB and XIC should be revisited in the light of this with a view to resetting the balance between services vs facilities, particular where there is no infrastructure to fine tune.[6]

Hence, the Office recommends a review of Parts XIB and XIC of the Act "with the intent of shifting the current emphasis on service enhancements to one that favours substantial investment in fundamental infrastructure in remote and very remote areas."[7]

B2 Multi-party arbitrations

The ACCC has raised the introduction of multi-party arbitrations, contending that the negotiate / arbitrate model of Part XIC has not worked as well as intended and that:

> "multilateral, public processes would seem likely to provide faster, more effective and more transparent price determinations than the current arrangement"[8]

An examination of the arguments for and against a multi-party approach leads us to conclude, however, that it is not a viable substitute for the current bilateral model.

The ACCC's argument for multi-party arbitrations is based on the standard nature of key access services, and the absence of undertakings to provide a benchmark for bilateral negotiations. The main benefits seen are a streamlining of the arbitration process. Practical experience to date with arbitrations suggests two barriers to success of this approach:

- Just as most parties have a preference for confidential bilateral negotiations, there is a demonstrated preference for bilateral arbitrations when negotiations fail. Attempts to join parties in arbitration have been strongly resisted; and

- Parties typically contribute highly sensitive commercial-in-confidence information to arbitration proceedings. There would be substantial practical difficulties in managing these confidentiality issues in multi-party arbitrations.

As a result it seems likely that multi-party arbitrations would not be readily embraced by industry, and would be more cumbersome to manage than the present bilateral system. Furthermore, due the different business circumstances of access seekers, it is likely that efficiency would be reduced by a "one size fits all" multi-party approach to arbitrations. On balance, therefore, it is not clear the ACCC's anticipated streamlining benefits would materialise, and some efficiency costs are

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6 Office of Communications, Science and Advanced Technology – Northern Territory; Comment on the Performance of Telecommunications Specific Competition Regulation at 6.

7 Comment on the Performance of Telecommunications Specific Competition Regulation at 6.

8ACCC, first round submission to Productivity Commission Inquiry..

anticipated. For these reasons Telstra sees little benefit in adopting a multi-party arbitration approach.

B3 Cable and Wireless Optus Analysis of the Industry

In its submission CWO claims the local loop is a natural monopoly, and that Telstra attempts to exploit the associated market power to the disadvantage of Australian consumers. Evidence tendered comprises:

- Selected quotes from a number of sources.
- Market share statistics for a range of wholesale and retail services.
- Telstra's offered prices for PSTN access, local call resale and unconditioned local loop relative to ACCC prices for these declared services.

We feel that CWO's arguments are seriously flawed and not compelling, and should be examined carefully by the Productivity Commission before they are afforded any weight of evidence. Our concerns with the CWO arguments are as follows:

- No empirical evidence is given on the question of local loop natural monopoly. This is in contrast to Telstra's careful analysis of this issue in Section 3 of its main submission.
- The claim that Telstra's market power in the local loop is reflected in Telstra's local loop line costs relative to ACCC estimates fails to recognise the enormous variability and inherent instability in ACCC estimates over time[9], and the obvious possibility that the ACCC has simply got it wrong. This issue is addressed in detail in appendix D of this submission.
- The high Telstra market shares for local loop based wholesale products – PSTN access, LCR and ULL – do not on their own demonstrate natural monopoly and market power circumstances. As covered in Section 3 of this submission, our view is that the situation is due instead to regulatory settings, including access prices (as well as retail price controls) which provide an enormous incentive to use Telstra's network rather than build their own local loops even if access seekers could do this more efficiently:
  - The ACCC sets the price of LCR well below its own estimate of "efficient" costs.
  - The ACCC sets the price of PSTN access at the lowest level in the world, and 30% below average cost-based charges worldwide, despite the clear cost penalties Australia geography imposes (see Appendix D of this submission).
  - The ACCC has proposed ULL charges at half the level proposed by Telstra ($36 compared with $63). See Appendix F of this submission.

9 See Appendix D on this issue.

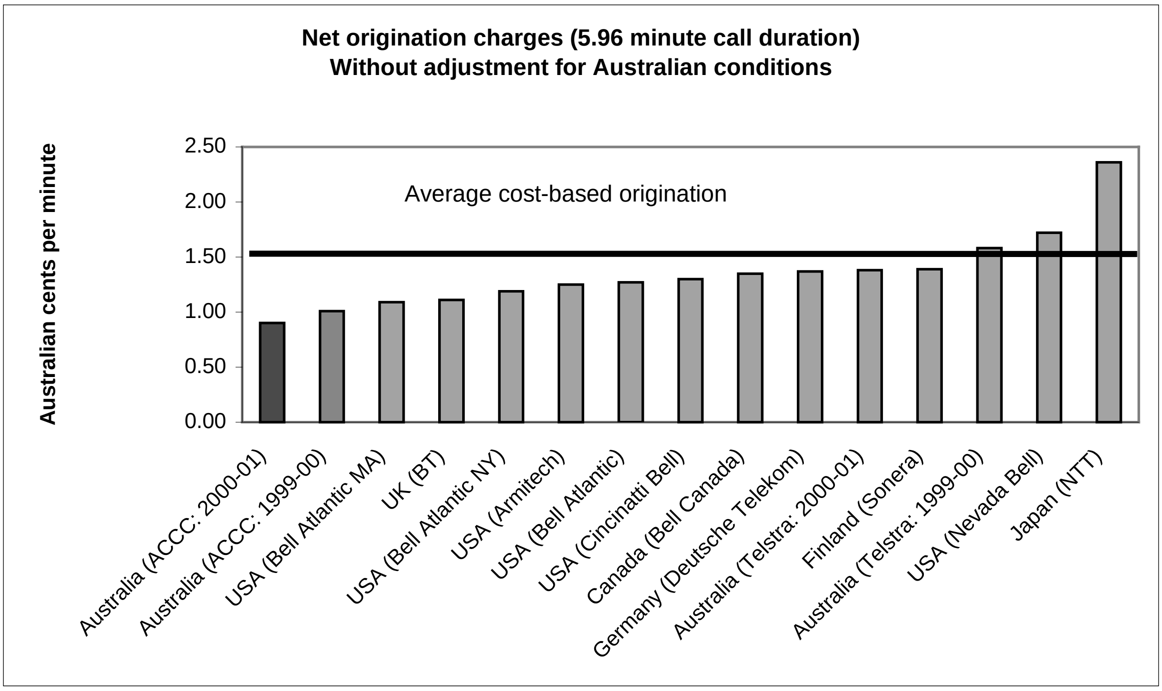
  - The $1.2 billion p.a shortfall the ACCC estimates is incurred as a result of the price cap on basic access also renders local loop infrastructure investment unattractive.

- The case of ISDN is in fact irrelevant. The fact that Telstra has high market share for this product simply reflects Telstra's early build of its ISDN network (1987), and that broadband technology has since moved on so there is no market interest in providing ISDN services.

- CWO claims that the benefits of industry specific regulation are demonstrated by the lower ACCC prices for PSTN access and local call resale relative to Telstra prices. While Telstra agrees that industry specific access arrangements should continue, we do not agree with ACCC costing for access services (see Appendix D), furthermore, the Commission should be aware that the international comparison of PSTN access charges put forward by CWO is incorrect.

CWO also presents a number of misleading comparisons in an attempt to demonstrate the benefits of sector-specific regulation. CWO presents an inaccurate international comparison of the PSTN charges proposed in Telstra's undertaking and those estimated by the ACCC. CWO fails to mention the fact that the Australian figures include the access deficit contribution, but the interconnect charges of comparison countries exclude such a charge. The appropriate comparison is of *net* interconnection charges, as presented by the ACCC in its final assessment of Telstra's Undertaking. Such a comparison is provided in Figure B.1 below. As this figure demonstrates, the ACCC's assessment of interconnect charges suggests that the Australian interconnect charge should be below the lowest rate in the world. Even a cursory review of the differences in the cost of providing services in Australia and the comparison countries suggest that the ACCC's analysis of interconnect charges is far too low.

Figure B.1: International Comparison of Interconnect Charges



B4 Leveraging copper lines to dominate new markets

CWO claims that network externalities and associated tipping effects, in conjunction with technological change and convergence, are likely to place more market power in the hand of the incumbent (Telstra). CWO claims that greater industry-specific powers are required to address this, including a dominance test.

In Telstra's view, the CWO assertions are without merit, for the following reasons:

- As detailed below in section B5, a dominance test would result in serious market distortions and inefficiencies;

- the concept of tipping is not unique to telecommunications and in any case, does not give rise to concerns about market power;

- the concept of network effects is not unique to telecommunications and does not require special industry specific laws. In any case, concerns about network effects are adequately addressed by having a sound access regime in place. The existence of an access regime for essential services – a concept Telstra supports – dramatically reduces the scope for an infrastructure owner to exercise market power in that, or related, markets;

- convergence, which is usually driven by technological change, occurs when firms that were previously in different markets begin to compete in the same market. The process of convergence inherently suggests a strong need for liberalisation and rationalising of regulations which apply to the converging markets. An industry-specific regulatory regime which, by definition, treats industries as inherently distinct, increases the scope for *stifling* such change.

Therefore, rather than convergence necessitating industry specific laws, the converse is true.

- existing general trade practices laws are adequate to meet any market power concerns that might arise, and are supported by Australia's intellectual property laws in this regard.

B4.1 Convergence, network effects, tipping and competition policy

Network goods and network effects are relatively new terms in economics and trade practices,[10] but are due to phenomena long discussed by economists: —externalities[11] and economies of scale and scope.[12] Unfortunately, a lack of understanding and clear analysis of these effects has led to unjustified claims of possible market failure.[13] Contrary to CWO's claims, network effects need not and often do not result in monopolisation. Power in one market does not typically result in power in another and Australian law can deal with issues of bottleneck access and leverage of power from one market to another.

B4.1.1 Network Effects

A network good increases the value gained by purchasers as the number of purchasers of the good rises. This is known as a network externality. When there is a network externality, purchasers are directly interested in how many other network participants there are. For example, the number of people on a telephone network matters. If a subscriber can call just about anyone they wish, then the network is more valuable to them than one that can only be used to reach a fraction of these people. This raises the question of whether market failure due to a network externality is possible.

B4.1.2 Tipping

When market participants are concerned about participation rates, a phenomenon called tipping can take place.[14] This in turn can create market power. Tipping occurs

10 Katz, ML and Shapiro, C (1985) Network externalities, competition and compatibility American Economic Review, 7, June, 424-40, provide an early discussion of network goods; for an overview from these proponents see Katz, ML and Shapiro, C (1994) Systems competition and network affect, Journal of Economic Perspectives, 8 (2) Spring, 93-115.

11 An externality arises when one person's action impacts on another in a way not mediated by the market (either indirectly through price or directly via a contract). The original idea goes back to Pigou, AC (1932) The Economics of Welfare, 2nd ed, London at 183 (cited in Head, JG (1969) Externality and public policy, Rivista di diritto finanziario efficient sciencza delle finanze, 28 (3) September, 383-414, and reprinted in Head, JG (1974) Public Goods and Public Welfare, Duke University Press: Durham: NC) at 185). Head's article provides a classic taxonomy of externalities and summary of the literature at that time.

12 Economies of scale were discussed in modern terms by JS Mill. Economies of scope were described by Alfred Marshall, under the name "joint supply" or "joint production". Both terms are used today (see for example, Chandler, Jr, AD (1990) Scale and Scope: The Dynamics of Industrial Capitalism, Belknap Press of Harvard University Press, at 17).

13 Market failure occurs when unfettered markets result in outcomes that are not efficient for reasons other than the exercise market power. As ¡Coase! and others have pointed out, the efficient alternative must be achievable if the definition is to be of value.

14 For an early discussion see Schelling, TC (1978) A Self-Forming Neighborhood Model, in Micromotives and Macrobehaviors, W.W.Norton, NY, 147-166.

when the customer-base of a network good reaches a critical mass. At this point demand begins to strongly favour this network good, often at the expense of competitors. A classic example of tipping was the competition which occurred between the VHS and Betamax formats for video. Despite Betamax's two-year head start, within five years of its US launch VHS became the dominant consumer-market taped video standard.[15]

It is important, however, to realise that:

- the mere presence of network effects neither implies that tipping will occur nor that the emerging networks will dominate the market; and

- even rapid and complete tipping does not necessarily imply substantial market power on the part of supplying firms, but when it does the net effect may still be beneficial to society.

As a result, network goods *per se* do not create policy concerns.

Tipping need not occur simply because a product is a network good; for example, competing networks can exist side-by-side. For example, Phillips and flat-head screwdrivers are competing network goods, but one shows no sign of displacing the other.

However, when tipping does occur, the emergent networks may be inherently small, or never achieve full-scale because of technological change:

- Many networks lose any network effects at a size that is quite small relative to the market. As a result, further tipping cannot occur. For example, network effects for chat rooms on the Internet are probably important when the number of people seeking access is small. A chat room, which has only a few score users, often will not supply enough variety in chat partners to make the site attractive. In these circumstances a network externality exists—every new user most likely brings benefits to the existing group. However, users of a chat room with several thousand members probably do not gain much or even any additional benefit from the arrival of a new subscriber. Indeed, as user numbers increase, the chat room provider might experience diseconomies of scale due to congestion. In sum, while chat rooms exhibit network effects, these are limited and will never lead a single chat room provider to dominate the market.

- The emergent network may not be able to displace important competitors in niche markets. Audio cassettes and the vinyl record existed side-by-side, in part probably because in certain niches each met different consumer needs. CDs largely displaced records and sapped the cassette tape market—a tipping phenomenon—but cassette tapes still managed to find a profitable niche in portable devices, in cars and also because they were recordable. Note also, the supply of cassettes and cassette players would have placed a constraint on the

15 Liebowitz, SJ and Margolis, SE (1995) Path dependence, lock-in and history, Journal of Law, Economics and Organization, 11 (1) 205-226, at 221. This paper also notes the visual and audio quality of the Betamax tapes were only marginally better than the VHS format, but that the longer recording length of the VHS format, and JVC's ability to partner with large VHS recorder manufacturers, were key in the success of the VHS standard. See also Sutton, J (1998) Technology and Market Structure: Theory and History, MIT Press, at 103.

price of CDs and CD players if these were to be monopolised (though they were not, as is seen shortly).

- The process of tipping can take so long that it becomes irrelevant. Holding all other things constant, it might have been the case that CDs would have eventually displaced cassettes.[16] However, other things change. Cassettes are now being displaced by new recordable formats that are better suited to portable devices than CDs or cassettes. Indeed, it is likely that digital recordable formats such as MP3 on hard disks and new media such as DVD-RAM disks, will eventually displace CDs.

Even when rapid and complete tipping occurs it often presents no competition law concerns, for at least two reasons:

- Tipping does not imply the emergence of a monopolist or even market power. Instead standards can emerge. For example, CDs and CD players are produced by a plethora of manufacturers. VHS cassette tapes and players provide a similar example in recorded video. GSM is the dominant mobile telephony standard in most countries in the world, and in many places has virtually replaced analogue service. However, competition in GSM equipment manufacturing has flourished. Indeed in all cases it is arguable that it was exactly the willingness of the relevant patent owners to commit to an open standard and reasonable licensing terms that allowed the tipping to take place.[17]

- Tipping that results in inefficient monopoly (as compared with a hypothetical first best benchmark) may still be more efficient than having competing services or standards, or imposing regulatory oversight. Further, it is likely that competition to become the favoured firm will involve sustained periods of substantial consumer benefits which in net outweigh any losses experienced by consumers once a winner emerges. That is, over the entire process the net present value of industry profits are competitive, as are the profits of the winning firm (allowing for risk, including the probability that it could have been a loser). In any event, no presumption exists that the consumer gains from this “competition for the market” will not outweigh any costs associated with foregoing “competition in the market” and to assume so would be hazardous.

Accordingly, the concepts of network effects and tipping are not unique to telecommunications and these concepts do not raise special concerns that justify the existence of, or the continuation of, special industry specific laws. Any concerns to which these concepts may give rise can be effectively dealt with under general competition law principles with an added safeguard from the access regime.

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16 In 1999, cassette-recorder sales accounted for 30 percent of the player market (Doan, Amy and Godwin, Jennifer, 1999, Winding down, Forbes, 4 October 1999), but full-length cassettes made up only 9 percent of cassette and CDs shipped containing recorded music (Recording Industry Association of America, 1999, Consumer Profile, www.riaa.com).

17 See, for example, Sutton (1998), at 412 on VHS; Garrard, GA (1998) Cellular Communications: Worldwide market Development, Artech House Publishers, 164 ff, on GSM.

B4.2 Australian law and leverage

In the preceding it has been demonstrated that:

- network effects do not automatically imply tipping, and tipping does not imply the emergence of a dominant firm—indeed the opposite is not uncommon; and
- technological change, especially radical technological change, does not result in increased market power on the part of incumbents, but more commonly the opposite, and this is true even for network goods and when there are very large economies of scale and scope available to those who are successful in the market.

This last section demonstrates that in any case, the legal and regulatory environment as proposed in the main paper makes it highly unlikely for such leverage to occur; but if it were to, then the perpetrator would be subject to prosecution under Part IV of the Act. In particular,

- the proposed access regime sharply constrains any market power that a firm such as Telstra might have over any bottlenecks, including, if this is indeed a bottleneck, access to copper pair on the local loop,
- the Australian courts face no difficulties in prosecuting anti-competitive leverage of any power not constrained by this access regulation,
- unlike the situation in the United States, Australian intellectual property law does not foster network effects, for the following reason. Australian IP law makes it far more difficult for the owner of unique software to prevent third party access to that software. More specifically, it allows software de-compilation for interoperability on a fair use basis, that is, at no fee to the de-compiler. As a result, copyright over standards embedded in software in switches, set-top boxes, etc. cannot be used to prevent third-party interconnection.

B4.2.1 Constraining market power—access regulation

The recommendations presented in the main body of the paper support an access regime, that is confined to bottlenecks and which takes account the legitimate interests of investors. Such rules would focus regulatory control exactly on sources of market power—bottlenecks—and would make the exercise of this power impossible by in effect mandating access (through the declaration process).

With access to bottlenecks available on reasonable terms it is difficult to see how a bottleneck owner could exercise market power over that bottleneck. If it manages to do so, that simply implies the access arrangements are in need of adjustment, something which the regime allows.[18]

In any case, if such action has anti-competitive effects, it is illegal and may be prosecuted under Part IV of the Act. Indeed, once a single variant of access is made

18 In practice, the ACCC has issued interim decisions which allows adjustments to be made at the affected parties' requests. This process means final determinations may not be issued for some years. In addition, if circumstances were to change the matter can be revisited (as was the case for analogue pay-television).

available on declared terms (for example, call origination and termination on a per minute basis), this determines:

- the prices that the regulated firm would be willing to supply all other substitutable types of access for (for example, via unbundled local loop or wholesaling for resale purposes); and
- downstream or retail prices.

The prices of all other forms of access are determined, because once the terms and conditions on one form of access are determined, the bottleneck owner’s profits from that service are also fixed, and the bottleneck owner will set prices for alternative forms of access so as to maximise its profits. At a minimum, these prices will guarantee, to the bottleneck owner, similar profits to those it obtains under the regulated terms and conditions. However, some of these alternative forms of access are likely to be more efficient than the regulated form of access, at least in certain niches. As a result, prices for these may emerge that both increase the bottleneck owner’s profit and raise overall efficiency.

Downstream or retail prices are determined by the forces of downstream competition. Retail telecommunications services are relatively readily contested, as the sunk costs associated with entry are low, so competitive forces can be relied on to force firms to pass on to consumers the benefits of low costs. These press overall prices toward overall costs. Individual firms will jockey for better position through different product and pricing bundles, and by otherwise differentiating their service, but the effect of competition is to sharply constrain firms’ choices in these matters, and to prevent any firm from gaining greater than normal returns over any length of time.

As a result, the desired trade practices outcomes could be achieved even with no further regulation of prices (either at the input level or, where services are reasonably competitive, at the retail level).

B4.2.2 The abuse of market power—the *Trade Practices Act* 1974

Despite the presence of access regulation on bottleneck facilities, there may still be a concern that a firm which controlled such facilities could anti-competitively leverage its position into other markets. However, there is nothing to suggest that the courts would have any unusual difficulties in enforcing the provisions of Part IV of the Act despite the presence of network effects, nor that these provisions fail to cover any form of anti-competitive behaviour made possible by network effects. A wide range of industries which are currently only subject to Part IV of the Act have strong network characteristics and raise no concerns of this type. There is no reason why the telecommunications industry cannot be similarly treated.

B5 Reintroduction of the dominance concept

CWO has proposed the reintroduction of a dominance test. However, the adoption of a dominance test would result in asymmetric regulation of access and conduct in the Australian telecommunications industry. This, in turn, has the potential to give rise to serious market inefficiencies.

A finding of "dominance" by a firm typically triggers specific *ex ante* regulation of such firm's interconnection charges and general conduct covering price discrimination, as well as restrictions of activity to prevent leveraging of market power from one market into another. Only firms found to be dominant would be subjected to such regulation, while other firms would be free from this intervention. CWO cites as primary precedent for this proposal recent draft directives published in July 2000 by the European Commission (hereinafter referred to as the "Draft Directives").[19]

The application of such a test would have the following effects:

- the application of a dominance test to the conduct regime would mean that Telstra was subjected to constraints that did not bear on other suppliers.[20] This asymmetrical regulation would undermine Telstra's ability to compete, and hence tend to transfer output from Telstra to other carriers – regardless of relative efficiency. Telstra does not believe that such an outcome – with its attendant costs in terms of allocative, productive and dynamic efficiency - could be consistent with the achievement of the objectives of efficient use of, or investment in, telecommunications infrastructure or, consequently, the promotion of the long-term interest of end-users;

- in practical terms, the dominance test, as proposed by CWO, would mean that only the assets of a firm with the largest market share at the national level would be subject to access regulation. In practice this would mean that in parts of Australia – such as the CBD of Sydney where there are at least 10 other competing access networks – Telstra would be regulated, while the remainder would not. To regulate a single network in this manner will – particularly in the presence of artificially low access prices – inefficiently distort consumption decisions between the various networks, and distort the volume of investment undertaken in the industry; and

- the application of a dominance test to the access regime would render the regulator incapable of dealing with the so-called 'non-dominant' network issue discussed in section 3 of the main body of this submission.

Furthermore, concerning the EU Draft Directives, CWO's proposal is inappropriate for three reasons:

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19 Proposal for a Directive of the European Parliament and of the Council on a common regulatory framework for electronic communications networks and services (Brussels, 12.7.2000, COM(2000) 393 final, 2000/0184 (COD)); Proposal for a Directive of the European Parliament and of the Council on access to, and interconnection of, electronic communications networks and associated facilities (Brussels, 12 July 2000, COM(2000) 384). The Draft Directives cited by CWO as precedent for its own proposals would capture under ex-ante regulation of access and interconnect pricing all firms above a threshold of significant market power. However the Explanatory Memorandum for the Directive on Interconnection sets out that this threshold has been redefined on the basis of the "competition law concept of dominance." The Explanatory Memorandum to the directive on a common regulatory framework also explains that the concept of significant market power has been modified to cover the concept of a dominant operator.

20 In practical terms, Telstra believes that the application of a dominance test in Part XIB would have limited practical import, as the regime is currently in practice exclusively applied to Telstra.

- European Union (EU) law does not clearly define dominance, and the adoption by Australia of the proposed EU approach is likely to lead to considerable confusion. Adopting this approach would also increase the likelihood of a lower standard for regulatory intervention, which is at odds with the increasingly competitive nature of this industry. However, if dominance tests are adopted, they should be in their entirety, and dominance should be understood as a position in which a firm can effectively act as if it faced no competition;

- As the EU economic and legal context is unique, and its telecommunications markets less liberalised, the adoption by Australia of rules deigned for the EU environment would create severe market distortions, by unnecessarily increasing current regulatory restrictions and further constricting choice. The Australian market, with nearly a decade of liberalisation experience, is at quite a different stage in its development;

- Finally, the EU Draft Directives would result in unnecessary over-regulation of the Australian telecommunications markets.

B5.1 Dominance: Australian and EU contexts

The concept of dominance has an Australian legal context,[21] but one that is quite different from that adopted by the EU. According to classical microeconomic theory, a firm is dominant if it controls the market. A dominant firm is fundamentally unthreatened by its competitors, either because those firms are and are expected to remain too small to substantially matter, or because the dominant firm can force or manipulate its competitors to behave in ways beneficial to it.[22] Similarly, in a wide class of economic models, a “dominant firm” has the capacity to set price in a manner very similar to a monopolist, but faces “fringe competitors,” who possess no significant market power.[23] As a result, a dominant firm is only effectively constrained by market demand.

The Australian telecommunications policy and law view of dominance is consistent with the economic theory described above. The Australian Telecommunications Authority’s (AUSTEL) subscribed to this view, defining dominance as the ability to: (1) act independently of competitors; (2) prevent real competition (either in the present or in the future); and (3) manipulate the actions of other firms.[24] The Australian courts have taken a similar view:

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21 Both significant market power and dominance are of interest under the Telecommunications Act 1991 and the TPA. For example, § 28 of the Telecommunications Act 1991 (now repealed) stated that a carrier is taken to be in a position to dominate a market, if it would be so taken under § 50 of the TPA, as in force before the amendments made in the Trade Practices Legislation Amendment Act 1992 which removed the reference to dominance.

22 Geroski PA and Jacquemin, A (1984), “Dominant firms and their alleged decline,” 2 International Journal of Industrial Organization 1-27 at 3.

23 While in aggregate fringe firms may reduce market demand, no fringe firm on its own can influence price or total market supply in a meaningful way. Nor are fringe firms able to coordinate their efforts. See, for example, the industrial organisation textbook, Carlton and Perloff, Modern Industrial Organisation (2nd ed.) (New York: Harper Collins, 1994), 8, 158ff.

24 AUSTEL, 1993, Market Dominance Guidelines, Discussion Paper (Melbourne, May 1993), at 8.

> The dominant position relates to a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained in the relevant market by affording it the power to behave to an appreciable extent independently of its competitors, its customers and ultimately of the consumers.[25]

While the EU has a concept labelled "dominance," it is not equivalent to the Australian understanding of the term, and it is thus dangerous to import EU jurisprudence on the subject into Australian thinking. Moreover, national courts of the EU Member States seem to have defined it in a way bordering on inconsistency, which makes its interpretation even within the EU uncertain. On the one hand, the United Kingdom's Office of Fair Trading (OFT) and the European Court of Justice (ECJ) adopt a stance similar to the Australian interpretation of dominance.[26] However, this concept of dominance has often been applied in a manner that suggests something much weaker than the ability to behave independently of competition.[27] The OFT, for example, has suggested that dominance may be possible when a firm does not have substantial market power, even as it considers the ability of competitors to "behave independently" as an important factor in determining dominance.[28]

Indeed, the true position of the EU on dominance is difficult to determine, which makes its application to the Australian context result in uncertainty at best. While high market shares are no guarantee of a finding of dominance or excessive market power, the European Commission has also suggested that a firm holding a market share as low as 20% may still be found to be dominant.[29] Commentators on EU competition law have observed that the notion of dominance may not necessarily require substantial market power.[30] For example, in the *United Brands* case the ECJ found that United Brands enjoyed a dominant position in the market, although the firm had no influence over price.[31] And although the OFT has observed that the ECJ assumes dominance if the firm persistently maintains a market share exceeding 50%,[32] national courts of the Member States have recognised that even considerably higher market shares may not be evidence of dominance. For example, a merger of Alcatel with Telettra was allowed because of strong buyer power, even though it

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25 Trade Practices Commission v Arnotts Ltd, [1990] ATPR ¶41-002 at 51-048 (Beaumont J).

26 The OFT has often quoted the ECJ's definition of dominance: "a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by affording it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of consumers." United Brands Co. and United Brands Continental BV v Commission (27/76), [1978] E.C.R. 207, [1978] 1 C.M.L.R. 429, C.M.R. 8429; quoted in Office of Fair Trading, Competition Act 1998: Assessment of Market Power, ¶ 2.09.

27 See, for example, J. Ordover, "Market dominance and its abuse," World Bank Course Materials (16 December 1998).

28 Office of Fair Trading, Competition Act 1998: Assessment of Market Power, ¶ 2.10.

29 M. Furse, Competition Law of the UK and EC (London: Blackstone Press Ltd, 1999) at 200

30 Valentine Korah, An Introductory Guide to EC Competition Law and Practice, 5th Ed. (Oxford: Sweet & Maxwell, 1994) at 4.

31 United Brands (27/76), [1978] E.C.R. 207; Korah (1994), 13, 78-9.

32 Office of Fair Trading, The Competition Act 1998: Assessment of Market Power, ¶ 2.11.

resulted in a post-merger combined firm market share of 83%. Similarly, a merger of Courtaulds with SNIA was permitted due to strong actual and potential competition, even though it resulted in a post-merger combined firm market share of 65%, more than double the share held by the largest of the participating firms.[33] However, perhaps reflecting the incorporation of social goals into EU competition law, firms have been found to be dominant even with market shares of only 40% or less.[34]

The EU concept of joint or collective dominance[35] is also not easily applicable to the Australian context. This concept is considerably looser than the idea of a dominant firm, and does not resemble any concept analogous to the idea of a firm with substantial market power in Australian competition law. The EU concept of joint dominance seems to target oligopolistic behaviour between firms, which individually might not hold market shares characteristic of dominant firms.[36] If so, dominance as employed by the ECJ is indeed much broader than the Australian competition law understanding of dominance.

Telstra thus cautions against simplistic representations as to what is happening with EU regulation of telecommunications. Telstra submits that while CWO recommends the adoption of the European Commission's proposed dominance provision, it does not fully understand the implications of such an adoption. Adopting policies similar to those endorsed in the Draft Directives would involve far-reaching regulation, both of access and conduct that is manifestly inconsistent with the deregulatory direction of Australian government policy.

B5.2 The difference in stages of telecommunications liberalisation in Australia and the EU

Furthermore, Telstra submits that the proposed EU competition regime regarding telecommunications markets is inapplicable to Australia, given Australia's relative advancement in the liberalisation of such markets. Despite efforts to enhance competition, much of the EU has come late to liberalisation, which has contributed to the development of a regulatory framework in which the market power of incumbents has not been subjected to significant challenge.[37] Australia is well ahead

33 Nevan, et al, "Enforcement of the European merger regulation," in L. Phlips, ed., Applied Industrial Economics (Cambridge: Cambridge University Press, 1988) at 424. Nevan lists three separate pre-merger market shares for the Courtaulds transaction, of 32%, 10% and 23%.

34 Hay, D, "Is More Like Europe Better? An Economic Evaluation of Recent Changes in UK Competition Policy," in Green, N. & A. Robertson, eds., The Europeanisation of United Kingdom Competition Law (Oregon: Hart Publishing, 1999), 35-59; in Rewe/Meinl and Hutchison/ECT/RMPM market dominance was established at market shares of 37% and 36%, respectively.

35 Guidelines on the application of the EEC competition rules in the telecommunications sector (91/C 233/02) http://europa.eu.int/comm/competition/antitrust/legislation/guipref_en. html; the Airtours/First Choice case where it was held that a situation of collective dominance between the merged Airtours/First Choice and the two other large, vertically integrated suppliers that would remain (Thomson and Thomas Cook), would substantially reduce competition in the short-haul package tour market in the UK. European Commission, XXIXth Report on competition policy (Brussels, 1999) at 52 (Box 6).

36 Whish, R, and Sufrin, B, Competition Law (3rd ed.) (Butterworths, 1993), 280-282, 486-90. Note that the authors state (at 487) that the attraction of collective or joint dominance from the Commission's perspective is its applicability towards non-colluding oligopolistic behaviour.

37See http://europa.eu.int/comm/competition.

of all the Member States except for the United Kingdom in its liberalisation of trunk and international call services, and well ahead of over half of the Member States in its liberalisation of mobile call services [38]. While these policies may or may not be applicable in the European context they are best viewed as 'retro' in the Australian context.

B6 Cease and desist powers

An argument raised by the ACCC, and some carriers including AAPT and CWO, is that the rapid rate of change in the telecommunications industry, and the potential for anti-competitive behaviour by incumbents, means that the ACCC must have the power to issue "cease and desist" orders, in order to respond swiftly to anti-competitive conduct. Although the ACCC notes that the originally proposed ACCC power to require mandatory compliance by a carrier or carriage service provider was not enacted following advice that such a provision would be constitutionally invalid, the calls for a cease and desist power continue.[39] For example, AAPT argues that this power should be included in Part XIB of the TPA, although it provides no support for this argument, other than that the United States Federal Communications Commission and Federal Trade Commission possess them, and that it will give the ACCC a more immediate and effective procedural mechanism.[40]

Telstra submits that there are continuing issues of constitutional validity in respect of a cease and desist power, as it would give an administrative body (the ACCC) a power that is only properly vested in the judiciary. The Australian Constitution is clear in its apportionment of the powers and responsibilities for the branches of government, and the assertion that the ACCC could issue competition notices with the force of law is clearly unconstitutional. Cease and desist powers are not constitutionally valid when exercised by an administrative body.

In its submission, the ACCC proposes to introduce an administrative model under Part XIB that would allow it to prescribe standards of conduct having regard to competition and public interest criteria, thus avoiding constitutional difficulties. The ACCC stresses that this would only be an option in limited circumstances but the effect would be to require a person to engage in conduct as specified by the ACCC, that is, conduct that would be expected in a competitive market.[41] AAPT also stresses that the burden of proof would be on the ACCC to demonstrate that a cease and desist order was warranted and that decisions to issue orders would be subject to review. Telstra rejects this proposal as a differently worded version of the competition process proposed and rejected in 1995. Like the competition direction power, such a scheme would place judicial power in the hands of an administrative body and also be unconstitutional. Furthermore, Telstra submits that the safeguards required to ensure the constitutional validity of the orders would require significant

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38 The United Kingdom liberalised its trunk and international telecommunications markets five and six years earlier, respectively, than Australia.

39 ACCC, Submission to the Productivity Commission Review of Telecommunications Specific Competition Regulation (August 2000) at 16.

40 AAPT submission to the Productivity Commission Inquiry (7 August 2000).

41 ACCC, Submission to the Productivity Commission Review of Telecommunications Specific Competition Regulation (August 2000) at 77.

ACCC resources and add considerable time to the process, eroding the supposed objectives behind its introduction.

In its 1993 Discussion Paper, the Australian Law Reform Commission ("**ALRC**") considered the effect of introducing a cease and desist power within the Act to be exercised by the Trade Practices Commission, and concluded that it would not be an effective mechanism.[42] The ALRC highlighted the following points against the introduction of this type of power:

- the regulator would have to expend time and resources on evidence gathering to satisfy its burden of proof before it could issue an order, or else the order would be challenged and struck down;

- constitutional power or lack thereof is an issue in respect of an administrative body being able to issue orders that have legal force;

- the requirement that natural justice must still be observed may make the process take longer than obtaining an urgent (interim) injunction;

- decisions of this nature would be open to challenge so this may subject the regulator to more administrative review than before; and

- a party may still refuse to comply with the order, forcing the regulator to go to court to get the order enforced, removing any time efficiencies.

Finally, neither the ACCC nor AAPT acknowledge the possible prejudice against a carrier that is the subject of a cease and desist order. There is a strong likelihood that carriers would become risk-averse in their behaviour and not be willing to engage in legitimate competitive conduct that benefits consumers.

B7 Compulsory lodgement and variation of undertakings

The ACCC contends that it should have the power to require access providers to lodge undertakings and to amend these undertakings .[43] Furthermore, it would appear that the ACCC is suggesting the introduction of these powers without an adequate review mechanism of the ACCC's assessment of the Undertakings.

Such powers, the ACCC argues, would eliminate the "problem" of access where pricing disputes are being resolved privately by way of arbitration or negotiation. By introducing a power to request and amend undertakings, the ACCC asserts, it will be able to increase certainty and efficiency, reduce the number of disputes notified and diminish the need for time consuming and lengthy arbitration.

Telstra is of the view that implementation of the ACCC's proposal would completely subvert the intent of part XIC, and for that matter part IIIA, concerning both the purpose and nature of undertakings and the primacy afforded commercial negotiation. Division 5 of Part XIC sets out the procedures relating to access

42 ALRC, Discussion Paper 56, Compliance with the TPA (November 1993), Chapter 7.

43 ACCC , Submission to the Productivity Commission Review of Telecommunications Specific Competition Regulation (August 2000) at 11.

undertakings. The underlying principle behind undertakings is that the access provider is given the opportunity to set its own terms and conditions in relation to how it will address and comply with the standard access obligations that attach to the declared service. The access provider formulates the undertaking and states that it is prepared to comply with the terms and conditions in that undertaking. The ACCC then decides whether to accept the undertaking and in reaching a decision is required to invite public submissions and assess the undertaking against a range of criteria to ensure that it is fair and reasonable.

Once the undertaking is accepted by the ACCC, the carrier is bound by the undertaking and access seekers can seek access to the declared service with the knowledge and certainty that the access provider will comply with its stated terms and conditions. Equally, an undertaking limits the ACCC's power to issue determinations in arbitration disputes insofar as a determination must not be inconsistent with an undertaking.

In recognition of the pace and nature of change that occurs within the telecommunications industry, there are provisions allowing an access provider to withdraw, vary or replace an undertaking. This enables a carrier to take account of efficiency gains as well as technological developments without requiring it to go through a full inquiry or determination process. The withdrawal power under section 152CA, in particular, provides a carrier with the crucial ability to remove its offer from the market should the terms of the undertaking become unsustainable given market conditions.

Telstra submits that the introduction of a power to require and/or amend undertakings runs against the objectives that underlie the submission of undertakings by access providers, distorting the above processes and rendering the undertaking provisions totally ineffective. Furthermore, the power to demand an undertaking be lodged, and the scope to alter an undertaking, means simply the power to set access prices across the whole market. The ACCC proposal should be clearly recognised as such.

Appendix C - Issues raised in Terms of Reference and Productivity Commission's Issues Paper

The Terms of Reference for this Inquiry and the Commission's Issues Paper raise a number of issues on which Telstra wishes to comment:

- Record keeping rules
- Tariff filing requirements
- Number Portability
- Preselection
- Facilities Access.

Telstra's comments in relation to each of these issues are outlined below.

C1 Record Keeping Rules

Telstra believes that the ACCC's powers in relation to the record keeping rules ("**RKRs**") must be substantially curtailed so as to ensure that there is a clear relevance between the ACCC's use of its powers and the information acquired from Telstra. Furthermore, the ACCC should be explicitly required to assess (and clearly state) why the onerousness for carriers of providing the information sought under the RKRs is outweighed by the benefits of the ACCC acquiring that information.

As discussed below, Telstra considers that the general aspects of the ACCC's draft general financial record reporting requirements are reasonable, as the compliance burden is not unduly great and this information may assist the ACCC with its market conduct and access investigations. The same cannot be said, however, of the ACCC's proposed requirements for Telstra to provide the ACCC with "supplementary reports" under the general financial RKRs architecture. Likewise, in its draft paper relating to a general non-financial RKRs architecture, the ACCC appears to have overstepped any bounds of reasonableness and has not identified why the onerousness for Telstra of providing the information suggested, would be outweighed by the benefits to the ACCC of acquiring the information.

Furthermore, concerning the *ad hoc* use of RKRs by the ACCC, the ACCC appears to have had little regard to the burden upon Telstra of complying with the ACCC's requirements. In this regard, Telstra again submits that the ACCC should be explicitly require to consider (and identify) why the onerousness of complying with the RKRs obligations is outweighed by the benefits to the ACCC of obtaining the information.

C1.1 General Framework

Under section 151BU of the Act, the ACCC is empowered to establish record keeping rules ("**RKRs"**) to which telecommunications carriers must comply, for the purposes of discharging its functions under Part XIB of the TPA (competition rules), Part XIC of the TPA (access rules), and other statutory functions.

The legislation allows the ACCC to require carriers to keep and report on information for long term or short term, specific, purposes. The ACCC can therefore implement RKRs requirements on an ongoing, long-term basis or for ad hoc market conduct and/or access related investigations. It appears that the information the ACCC can require carriers to keep, includes both financial and non-financial information.

Furthermore, subject to specified legislative criteria, the ACCC is empowered to require carriers to disclose specified RKRs reports, either to the public generally or to specific parties.

C1.2 Financial Information

The ACCC has been developing a specification for financial RKRs since 1997. It was proposed that this framework would: require financial record keeping consistent with a full accounting separation regime based on historic costs; and seek to develop the keeping of records on Forward Looking Economic Costs ("**FLECs**") for declared services.

In 1999 the ACCC undertook a public inquiry process into the RKRs, but has not formally implemented any RKRs requirements. (Telstra understands this is because the ACCC has not resolved how to formally invoke the RKRs requirements in a legal sense). Nevertheless, Telstra has undertaken extensive financial systems changes in order to accommodate the anticipated RKRs requirements. Telstra has also been in regular contact with the ACCC in respect of refining and developing specific accounting issues in relation to the new reporting requirements, including auditing of its financial accounts.

Telstra believes that the general architecture for the RKRs recommended by the ACCC in its Discussion Paper strikes a reasonable balance between maximising the high level information which is relevant to the ACCC's statutory objectives and limiting the burden of the RKRs in terms of implementation and the ongoing administrative costs of recording information. When implemented,[44] the general architecture recommended by the ACCC will provide the ACCC with a detailed analysis of service costs and with a clear insight into the cost structures of Telstra, at both total wholesale and retail service level. For each wholesale and retail service, the ACCC's RKRs model will provide cost information defined by category (e.g. CAN, transmission, human resources, etc), cost type (i.e. Operations and Maintenance, Depreciation and Mean Capital Employed) and attribution type (i.e. Direct, Attributable and Unattributable).

The recommended methodology will assist the ACCC in its market conduct regulation by revealing the direct, directly attributable and unattributable costs for retail (and declared) services. These may then be compared with revenues earned to calculate the profitability of any service. The framework can be used as a first point of reference for assessing allegations such as predatory pricing or vertical price squeeze allegations.

In addition, the general framework establishes a reporting regime which allows auditing by an independent body to the ACCC's satisfaction. This is clearly of importance to the feasibility and workability of any RKRs reporting methodology.

Telstra has, however, serious concerns about the ACCC's proposed "Ancillary Reports". It is proposed by the ACCC that these reports will include a general reporting requirement in respect of the usage of PSTN network assets as well as providing Capital Adjusted Profit Statements and Mean Capital Employed statements for:

- All declared PSTN services that are consumed (including unbundled local loop), according to CBD, metropolitan, provincial and rural geographic segments;
- Transmission, including in relation to each intercapital link

44 In anticipation of the formal RKRs requirements, Telstra has established accounting systems and process that will allow Telstra to quickly transition to the new reporting arrangements. In fact, Telstra is already preparing accounting reports based on the new RKRs requirements.

- The Digital Data declared service, by CBD, metropolitan, provincial and rural geographic segments
- The GSM retail service, segmented by the terminating carrier of the call.

In Telstra's view the level of specificity and onerousness of the proposed Ancillary Reports would place an unreasonably high administrative burden upon Telstra. The purpose of the ACCC's proposed reporting requirements was to provide a general level of information to assist the ACCC with assessing particular competition and access issues. In Telstra's view, while disaggregation of cost and revenue information for such services may be useful for a particular inquiry, it cannot be justified as a general feature of the RKRs. Telstra does not record information on the basis of the reporting requirements identified in the Ancillary Reports and to require it to do so would impose enormous implementation costs. Therefore, Telstra considers that the information about any disaggregated aspects of the services should be sought by the ACCC through special studies as required.

C1.3 Non Financial Information

The ACCC released a discussion paper on non-financial RKRs in late 1999, but is yet to formally adopt a position on reporting requirements. However, based on the ACCC's discussion paper, many of Telstra's concerns in relation to the financial RKRs apply with equal force to the non-financial RKRs. In its discussion paper the ACCC suggested that it would use the non-financial RKRs powers to require information to be reported on operational support systems ("**OSS**") for declared services. This is the processes and data storage systems that are used in connection with declared services. The ACCC stated that it did not consider the provision of OSS reports to be too onerous.

Telstra's concerns regarding the burden of the ACCC's proposed approach for using the RKRs to obtain access to an access provider's OSS are increased by the fact that the ACCC has not indicated how, or indeed if, OSS reporting under the RKRs will be limited to particular declared services. The ACCC has not yet identified the range of services to which it believes the reporting requirements should apply, even though this would appear to be a primary input necessary to weigh up the relative costs and benefits of the proposed approach. Telstra is concerned that the ACCC may be intending for all carriers to report on the quality of supply of all declared services. This would be a major task, both for carriers to collect and provide the information and for the ACCC to interpret it.

The ACCC also indicated that it would use the non-financial RKRs to report on service standards in relation to the provision of declared services; that is, to determine whether the quality of a declared service provided by a supplier to an external acquirer is equivalent to that which it provides its downstream facility. However, many declared services are supplied to access seekers in different geographic areas, for different customer groups and using different parts of the access provider's network. The relevant standard of service for each access seeker will depend on the different combination of the characteristics of the declared service being supplied, as well as being influenced by the wider choices an access seeker may make as to quality / price trade-offs. The ability to make such trade-offs, and more generally to adapt supply to the circumstances of individual access seekers, is an important feature of the Australian access regime. A requirement to report on all possible combinations at six monthly intervals (as was proposed by the ACCC) would impose an enormous burden on access providers and, without substantial resources available to interpret this information, would do little to assist the ACCC in effectively monitoring compliance.

C1.4 Ad Hoc/Specific Inquiries

Examples of the ACCC's requirements in relation to the RKRs follow.

In August and September 2000, the ACCC issued its first issue-specific RKRs and two further draft RKRs. These relate to Unconditioned Local Loop Access (Service Delivery) ("**ULL**") and the other draft one related to switchports.

In the case of the ULL RKR issued in August, Telstra only knew of it was after it had been issued, when it was served on Telstra. The ACCC gave no prior notice or consultation in respect of that RKR. Furthermore, in the Switchports RKR, the ACCC has noted publicly that there is no reason to suspect that Telstra's conduct has been in breach of the competition rule.

Telstra believes that in these cases the ACCC is taking advantage of the broad language of its RKR power and is attempting to use it as an evidence gathering weapon that will enable it to anticipate potential complaints. Telstra further notes that the ACCC appears to recognise that information which it can obtain under the RKRs could be obtained under section 155 of the Act – a less onerous route of obtaining information, with far fewer long term compliance costs and obligations. For example, in its letter to Telstra dated 27th September 2000 concerning the RKR relating to ULL, the ACCC observed that –

> "In the event that the information sought … could not be obtained through the RKR, it is clearly information relevant to a designated telecommunications matter and thus capable of being obtained pursuant to Section 155 of the Trade Practices Act".[45]

Overall, Telstra submits that the ACCC is over-regulating Telstra under Part XIB and that these specific RKRs are another example of the ACCC imposing a regulatory burden on Telstra without proper justification, without due consideration of the onerousness of the reporting requirements, and without adequate consultation with Telstra.

In conclusion, Telstra's general concern with the RKRs is that the ACCC is implementing the RKRs requirements without sufficient regard to costs of compliance and without due consideration to whether the costs of providing the information are outweighed by the benefits to the ACCC of obtaining the information. In Telstra's view, this situation could be remedied with a legislative requirement that the ACCC balance these considerations when issuing RKRs. Such a requirement may overcome the ACCC's propensity to require information to be provided without sufficient regard to the costs of doing so.

45 Letter from M.Cosgrave (ACCC) to D.Shiff (Telstra) dated 27th September 2000.

C2 Tariff Filing

In Telstra's view, the tariff filing obligations are onerous and generally irrelevant to the ACCC's specific information needs. In spite of the administrative burden of complying, to Telstra's knowledge the tariff filing information has in only a handful of instances been relied upon by the ACCC to inform it in relation to specific investigations or inquiries. On this basis it is Telstra's view that the tariff filing obligations should be removed from the Act.

C2.1 Part XIB - Division 5

Division 5 of Part XIB of the Act requires Telstra to, at least 7 days (or less by ACCC decision) before imposing a new charge for a basic carriage service ("**BCS**"), or varying or ceasing a charge, give the ACCC a written statement setting out such information about its intentions as is required by the ACCC. Telstra alone is the only carrier required to provide BCS tariff filings to the ACCC

A number of considerations lead tot he clear conclusion that Division 5 of Part XIB of the Act is not necessary and should be repealed:

1. the ACCC has never made any enquiries about Telstra's standard filings

2. Telstra has to date reported more than two thousand non-standard tariffs to the ACCC. Only once has the ACCC requested further particulars about matters listed in the non-standard tariff information. This occurred in the course of an inquiry by the ACCC relating to discounts by Telstra against the standard form of agreement ("**SFOA**") for non-standard pricing and key customer contracts. In the course of that inquiry, the ACCC sought particulars about 12 customer specific non standard tariffs and approximately 24 mobile contracts.

3. Telstra, like other major carriers, provides full details of its BCS in an SFOA, a publicly available document. Like other major carriers, Telstra provides this document on its internet site. Telstra updates the document every time any alteration is made to BCS charges. This provides the ACCC with current information on Telstra's standard tariffs. Since there has only been one query from the ACCC, which related only to non-standard tariffs, Telstra considers that the requirement to continue provide this information (at considerable cost to Telstra) is unjustifiable.

    4. If the ACCC requires such tariff information, it can obtain the information by using its existing powers under the Act, namely the record keeping rules powers in Division 6 of Part XIB of the Act (subject to Telstra's comments above in subsection C1 of this appendix), or by issuing a section 155 Notice.

C2.2 Part XIB - Division 4

Division 4 provides the ACCC with the ability to direct a carrier or carriage service provider to provide tariff filings where that party has a substantial degree of power in a telecommunications market.

Since this power was given to the ACCC it has never been used; and in Telstra's view, it has never been needed. Furthermore, given the strength of competition in all markets, it is unlikely that this power will ever either be used or necessary. As is the case with Division 5 of Part XIB of the Act, the ACCC can obtain such information, if required, through invoking its record keeping rules powers under Section 6 of Part XIB of the Act or by relying on a section 155 Notice

C3 Number Portability

In Telstra's view, there are three key problems relating to number portability in the current regime:

- the ACCC has failed to adequately and consistently take into account the technical factors associated with number portability requirements;
- the ACCC has established pricing principles that are non-compensatory and which are at odds with economic efficiency;
- the absence of any merits review rights in respect of ACCC decisions on number portability.

In Telstra's view, the introduction of merits review rights in relation to the ACCC's decisions concerning the mandating of portability requirements and arbitrations would overcome these problems

C3.1 Implementation Requirements

In considering whether to mandate number portability, the ACCC is required to have regard to the long term interests of end users ("**LTIE"**). If the ACCC is satisfied that mandating number portability would be in the LTIE, then it may issue a direction to the ACA to include a portability requirement in the telecommunications numbering plan. The ACCC has so far mandated number portability requirements in relation to Local numbers, Inbound numbers and Mobile numbers.

Typically, in mandating portability, the ACCC does not have regard to the technical complexities of complying with portability requirements. The technical complexities involved in complying with portability obligations are significant; and substantial systems and process changes are involved to meet portability requirements. There is a tendency for the ACCC to mandate number portability without appropriate regard to the consequences of any requirements that compliance with number portability entails. Rather, after having a made a decision to mandate portability, the ACCC simply hands the responsibility for overseeing compliance with number portability to the ACA. In Telstra's view, there is an urgent need for the ACCC to take responsibility for ensuring that compliance with the portability requirements that it mandates are feasible for carriers.

Furthermore, in determining the implementation date for portability requirements, the Australian Communications Authority ("**ACA**") either has not recognised the complexity of portability requirements involved or has taken what appears to be an asymmetric approach to the determination and setting of implementation dates. An example is the period set by the ACA for the implementation of Inbound (1800/13) Number Portability ("**INP**") compared with the timing of Mobile Number Portability ("**MNP**"):

- In the case of INP, the ACA established an implementation date of 16th November 2000. That date allowed a total of nine months for the establishment of systems and processes for implementation of INP technology and requirements. This time frame, however, did not take proper account of the changes INP entailed. INP not only involved the introduction of portability for a range of services using these numbers - in Telstra's case there are 12 different customer services that utilise these number ranges – it also involved fundamental changes to the way in which number allocations were to occur.

- Telstra argued it need 15 months to undertake the necessary analysis, specification, design and testing to implement INP over its product range, once the interface speciation was available. These requirements were given inadequate consideration by the ACA in setting the implementation date; which, as noted, allowed only nine months for implementation. In Telstra's view, this was largely the result of a number of CSPs who argued that Telstra's 15 month timeframe was excessive. Telstra, however, is not aware of any such claim being substantiated with supporting information.

- The ACA took a much different approach to the implementation of MNP. After having been mandated by the ACCC in 1999, the ACA initially set an implementation date of March 2001 and then in May 2000 altered that implementation date to September 2001, on the insistence of CWO and Vodafone. Telstra, in contrast, supported the earlier implementation date of March 2001. Further, Telstra notes that the technical complexity of complying with MNP does not approach the complexity of INP - MNP does not require the significant additional complexity of a pooled number approach to allocation. Rather, under the MNP arrangements, the existing number block allocation arrangements are to be maintained.

C3.2 Pricing Principles

The ACCC has established pricing principles in relation to local number portability; and draft pricing principles concerning mobile number portability.

Number portability imposes real resource costs on the carrier that undertakes the porting function. Either the originating carrier or the carrier from which the called party has ported (the donor carrier) must establish some form of porting solution to identify and redirect ported calls to the carrier to which the customer has ported (the recipient carrier).

The key pricing question is how to recover these costs most efficiently. Telstra's submissions to the ACCC on local and mobile number portability have stressed the importance of recovering costs in line with cost causality[46]. That is, the costs associated with number portability should be recovered from those whose actions cause the costs to be incurred at the margin. This will ensure that customers are provided with the correct price signals when making decisions regarding porting.

46 See Telstra Response to the ACCC's Paper Entitled "Pricing Principles for Mobile Number Portability – A Draft Guide" April 2000.

Telstra has argued in its submissions to the ACCC that the most efficient means of recovering porting costs is to recover all directly attributable donor porting costs (ie transit and transfer costs) from the customers who choose to port and all common donor porting costs (ie system set-up costs) from end-users that benefit from porting more generally - either through the option to port, increased competition that porting may deliver, or not having to discover the new number of the B-party.

Such an approach would ensure that customers only port when the benefits associated with maintaining their current local or mobile number outweighs the directly attributable costs of implementing donor porting. If the benefits of porting fall short of these costs then clearly the value that the customer places on their current number is not sufficiently high to warrant porting that number. This does not mean that the customer should not change carriers; it simply means that when they change carriers they should also change numbers to avoid the cost of porting. This approach also ensures that any end-users that benefit from the porting more generally make some contribution toward recovering common porting costs. In addition, such an approach allows the carrier that incurs the cost of porting to fully recover those costs. As a result, this approach provides the correct incentives for the party that can provide the porting functions most efficiently (either the originating carrier or the donor carrier) to do so.

However, the ACCC has ignored Telstra's efficiency arguments and has instead set local number portability guidelines that require the donor carrier to recover all costs associated with implementing porting in their network. In its pricing guidelines the ACCC notes the obvious implications of it pricing principles that "as Telstra has around 99 per cent of customers, Telstra will inevitably be responsible for most of the call conveyance and customer transfer costs"[47]. As a result, the ACCC's guidelines were widely accepted by all carriers other than Telstra. For mobile number portability, the ACCC was under greater pressure from a number of mobile carriers to ensure that the donor carriers would not have to recover all of the costs of implementing a porting solution.

For mobile number portability, the ACCC proposed that the originating carrier be responsible for recovering all of the ongoing transit costs associated with mobile number portability and mobile carriers be responsible for the other costs that they incur in implementing and providing porting services.

The ACCC's guidelines for local and mobile number portability are completely at odds with economic efficiency principles. Under the ACCC's approach the customer that chooses to port incurs none of the costs associated with that decision and hence consumers will choose to port even when the costs of doing so outweigh their valuation of this service. Such an approach will lead to inefficient porting decisions, the misallocation of resources and hence substantial allocative efficiency losses. In addition, there is no incentive for parties to implement the most efficient porting solution, as the ACCC's approach does not permit costs to be recovered from the porting customer. Therefore, there is no incentive for the most efficient party to provide the porting functions which has the potential to create substantial productive efficiency losses.

47 See footnote 32 of the ACCC Pricing Principles for Local Number Portability – A Guide, June 1999.

Moreover, there is little prospect of any substantive review of an ACCC arbitration decision concerning number portability. In the event of a dispute concerning number portability pricing, the ACCC is empowered to arbitrate the dispute. Section 462 of the TA requires carriers and carriage service providers to comply with the ACA's numbering plan. Section 462(2) provides that where the numbering plan requires a carrier or carriage service provider to provide number portability in relation to the customers of a carriage service provider, where the parties are unable to agree on the terms of portability the terms are to be settled by an arbitrator. If the parties cannot agree on an arbitrator, the ACCC is to arbitrate. However, unlike the situation for access arbitrations, an arbitration determination made by the ACCC under s.462(2) is not reviewable on its merits to the Australian Competition tribunal..

Because of the far-reaching potential effects of a determination concerning number portability, Telstra considers that safeguards on appropriate use of the ACCC power to make determinations should be included in the legislation, recommends that the following provision be inserted into the *Telecommunications Act 1997*.

"462A Review by the Tribunal

(1) A party to a determination made under section 462 may apply in writing to the Tribunal for a review of the determination.

(2) The application must be made within 21 days after the ACCC made the determination.

(3) A review by the Tribunal is a re-arbitration of the dispute.

(4) For the purposes of the review, the Tribunal has the same powers as the ACCC.

(5) The member of the Tribunal presiding at the review may require the ACCC to give information and other assistance and to make reports, as specified by the member for the purposes of the review.

(6) The Tribunal may either affirm or vary the ACCC's determination.

(7) In this section:

"Tribunal" means the Australian Competition Tribunal, and includes a member of that Tribunal or a Division of that Tribunal performing functions of that Tribunal

C4 Preselection

Telstra's view on preselection is as follows:

- any pre-selection requirement should be confined to PSTN services, as there will be major costs, with little offsetting benefit, if pre-selection obligations are imposed in respect of any other services; and

- if there is any expansion of pre-selection obligations beyond the PSTN network, then there must be a careful assessment of the costs and benefits of that requirement.

Preselection was relevant to support the initial introduction of competition in PSTN services. However, there is no justification for extending the scope of preselection obligations to non-PSTN technologies. This will merely reduce incentives for access seekers to provide total customer solutions and deter investment in alternative infrastructure (if built); such as HFC, Fibre, Laser, LMDS and Wireless Local Loop.

Furthermore, preselection makes little sense in the context of new network technologies such as IP based networks. In this environment, the concept of “long distance” may not be relevant; and the requirement to adhere to a preselection obligation may create artificial distinctions between local and long distance calls. That is, distinctions may be retained that would not exist in the absence of an artificial regulatory mandate. In such an environment, absent a preselection obligation, any distinctions between local and long distance calls may well disappear.

C5 Facilities Access

Telstra’s view on the current facilities access arrangements is:

- The legal requirements in relation to facilities access are manifestly deficient in that Telstra has no right to refuse requests for facilities access based on Telstra’s reasonably anticipated needs. This could lead to situations of hoarding, which would dampen investment and work to Telstra’s disadvantage; and

- Legislative amendments are required to redress this situation.

C5.1 Regulatory Background

Part 5 of Schedule 1 of the TA deals with the granting by carriers of access to certain types of facilities, primarily towers and ducts. The ACCC has prepared a Code which does not recognise any right to refuse access on the basis that the second carrier has not provided reasonable notice (having regard to the first carrier’s planned uses of that facility). Telstra understands that this has been done on the basis of advice from the Australian Government Solicitor (“**AGS**”) that the ACCC does not have the power under the Act to allow a first carrier to refuse access on that basis.

C5.2 Problems with Part 5 of Schedule 1 of the TA

Telstra considers the fundamental problems arising out of Part 5 of Schedule 1 of the TA, and the Code made under it, are that:

(a) owners of infrastructure are positively disadvantaged in relation to the use of their own facilities, and have less rights to use them than access seekers; and

(b) there is a complete lack of clarity as to the relationship between first, second and subsequent carriers seeking access to the same facility.

These problems are demonstrated by the following examples.

Example 1:

- A carrier plans to install an antenna on one of its own towers. It may have obtained planning permission, ordered the equipment, and arranged for contractors to do the installation work. Just before the antenna is physically installed, the carrier receives an access request from an access seeker.

- According to the AGS advice, the access seeker immediately has an absolute right of access to the tower. If both requirements cannot be satisfied, then the request of the access seeker takes priority over the first carrier's own requirements.

Example 2:

- A carrier receives an access request from an access seeker requesting access to a tower in 5 years to install an antenna. The carrier immediately thereafter receives an access request from a second access seeker requesting access to the same tower in 6 months time.

- According to the AGS advice, if both requirements cannot be satisfied, the first access seeker's request takes priority over that of the second access seeker, despite the fact that there is no obligation on the first access seeker to make use of the facility in the intervening period.

On the AGS view and under the Code, there are few (if any) controls over the making of requests by access seekers. Access seekers may make requests for access to facilities at a future time. They will have indefeasible rights to access from the time the request is made, but will have no obligation to actually act on that right of access. Should they not utilise that access within the specified time period, the rights of access does not expire, nor do they suffer any consequences.

C5.3 Impact on Investment and Market Conduct

The problems identified above, if not resolved, would result in behavioural changes by market participants which will be detrimental to the overall achievement of the objectives of the *Telecommunications Act* and Part XIC of the *Trade Practices Act*. In particular:

(a) The Code will reduce investment in infrastructure

The Code could inhibit investment in the basic network infrastructure on which the supply of carriage and content services to the public rely. Carriers invest in towers and ducts not just for existing requirements but for their own future requirements using complex provisioning formulae which balance the initial capital cost of construction against expected utilisation and the costs of subsequently adding capacity. Distortions to the ability to provision for future needs arising from the facilities access arrangements will result in

- less infrastructure built at a higher cost, a reduction in facilities based competition and an overall reduction of benefits to end users; and

- less sharing of infrastructure as no or less excess capacity will be constructed, something which is clearly inconsistent with the intention of Parliament in passing Part 5 (which was in fact to encourage co-location) .

(b) The Code will not result in the efficient utilisation of available capacity

The failure to include provisions which impose a discipline on access seekers to lodge genuine access requests and to act on them will result in regulatory gaming by access seekers to lodge multiple access requests to "bank" sites which will have the effect of preventing competitors, or indeed the facility owners themselves, from obtaining access to those sites.

C5.4 Suggested Approach

Telstra suggests that certain principles currently embodied in Part XIC of the Act in relation to the supply of declared services should be applied to facilities access under Part 5 of Sch 1 of the Telecommunications Act. Under section 152AR(4) of Part XIC, a carrier is not obliged to provide a declared service where, in particular, it would prevent the carrier from obtaining a sufficient level of that service for its own reasonably anticipated requirements. Specifically:

- Telstra believes it would be necessary to make a minor amendment to s152AR(4) principles if they were to be incorporated into Part 5, to ensure that the first carrier does not need to take account of the second carrier's "reasonably anticipated requirements", but rather would take account of their "actual requirements". This would ensure that the problem of hoarding of capacity by access seekers is avoided.

- In addition to the s152AR(4) principles discussed above, Telstra believes there should also be a minor change to the existing clause 33(4), 34(4) and 35(4) to allow carriers, when considering the issue of technical feasibility, to consider whether compliance would be environmentally and aesthetically feasible. Such a provision would, for example, preclude the destruction of the benefits of structures such as towers built into church steeples or in such a way as to comply with environmental concerns.

Drafting to give effect to these proposals follows:

Telstra recommends that the following provision reflecting section 152AR(4) of the Act is incorporated into Part 5 of the TA:

"33(1A) Sub-clause 33(1) does not impose an obligation on a carrier to the extent (if any) to which the imposition of the obligation would have any of the following effects:

(a) preventing a carrier who already has access to the telecommunications tower from obtaining a sufficient amount of access to be able to meet the carrier's actual requirements, measured at the time when the request was made;

(b) preventing the first carrier from obtaining a sufficient amount of access to be able to meet the first carrier's reasonably anticipated requirements, measured at the time when the request was made;

(c) preventing a person from obtaining, by the exercise of a pre-request right, a sufficient level of access to the telecommunications transmission tower to be able to meet the person's actual requirements;

33(1AA) In this section:

pre-request right, in relation to a request made for the purposes of section 33(1), means a right under a contract, or under a determination (within the meaning of section 36), that was in force at the time when the request was made.

Corresponding changes need to be made to clauses 34 and 35.

Telstra also suggests that the following provision is incorporated into Part 5:

"33(1B) A second carrier's right of access granted pursuant to sub-clause 33(1) will expire if:

(a) the second carrier has not installed a facility on the space to which access has been granted within **[6]** months of the date the right of access is granted by the first carrier to the second carrier; or

(b) the second carrier does not reasonably intend to install a facility on the space to which access has been granted within **[6]** months of the date the right of access is granted by the first carrier to the second carrier.Corresponding changes need to be made to clauses 34 and 35.

Telstra also proposes that the following provision is incorporated into Part 5:

"33(4) …..

(ba) whether compliance is likely to damage or destroy or otherwise detrimentally effect characteristics of an environmental or aesthetic nature of the tower; and

(c) [include reference to paragraph (ba)]."

Corresponding changes need to be made to clauses 34 and 35 of the TA.

Appendix D - Telstra's concerns with the ACCC's approach to PSTN interconnection charges

Telstra has two major concerns with the ACCC's application of the telecommunications access pricing principles in the context of assessing Telstra's PSTN interconnection charges:

- First, the ACCC has relied solely on the Total Service Long Run Incremental Cost ("**TSLRIC**") methodology to assess Telstra's PSTN interconnection charges. The results of such an approach are extremely sensitive to the input assumptions and methodologies used and the Commission assesses Telstra's proposed charges on the basis of one set of input assumptions, without any sensitivity analysis of other reasonable input values.

- Second, the ACCC's application of the TSLRIC concept is particularly distorting as it systematically under-prices access to the incumbent network.

This attachment details Telstra's concerns, summarising the many fundamental errors the ACCC has made in its application of TSLRIC in costing PSTN terminating and originating access charges.

Sole reliance on TSLRIC point estimate

Internationally, TSLRIC has been used to set bounds for access prices. The concept was originally devised to set a *lower* bound for certain charges set by US access providers – that is, as a means of determining a floor below which prices could be considered to be predatory. In contrast, the ACCC uses TSLRIC to set a single maximum access price. This approach assumes far too much accuracy on the part of economic cost models built on the basis of purely hypothetical networks.

The results produced from the TSLRIC model used to determine appropriate PSTN access charges were 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 produces estimates differing by 25 per cent.

In light of this, a more sensible option would have been to determine the reasonable range of TSLRIC estimates, by varying key parameter inputs. The analysis should then be supplemented with an examination of Telstra's actual replacement costs and international cost-based interconnect charges.

Telstra's actual costs are useful in that they provide a sanity check on the range of TSLRIC estimates and hence an indication of the location within the range that is likely to be most appropriate. They are also useful in determining the level of the access charge that would encourage efficient investment. This is because Telstra's competitors should be encouraged to build their own networks if the costs they would incur in doing so are below the costs Telstra is actually likely to incur in carrying out network replacement. As a result, it is Telstra's actual likely replacement costs, rather than the costs associated with a hypothetical new build network, that provide the best guidance to “build versus buy” decisions. Failure to take these costs into account will distort investment decisions going forward.

In assessing Telstra’s Undertaking the ACCC compared its TSLRIC results with international cost based interconnection charges, yet failed to draw any conclusions from this comparison. The ACCC’s TSLRIC estimate is the lowest of all comparison countries in 1999-00 and would be even lower for 2000-01. When consideration is taken of the differences between Australian conditions and those of the comparison countries, and more specifically of the likelihood that Australian costs are markedly higher than costs in the comparator countries (as recently documented in a Productivity Commission report[48]), the ACCC’s TSLRIC estimate is clearly unreasonable.

Application of TSLRIC

In undertaking a TSLRIC modelling exercise there are literally hundreds of input parameters and methodological choices that are required. Telstra’s main concerns with the input parameters and methodologies used by the ACCC are set out below.

Provisioning of the Customer Access Network

The ACCC adopted a static rather than a dynamic view of network provisioning. In its TSLRIC model the ACCC used a provisioning rule of 1.33 copper pairs in the distribution area of the CAN and 1.25 in the feeder area of the CAN, while Telstra has argued that the appropriate figures are 2.0 and 1.66, respectively.

While it may be the case that a lower level of provisioning across the whole PSTN could service network demand at any one moment in time, Telstra’s PSTN is extremely dynamic with end-users moving continuously and the level of demand differing significantly and to some extent unpredictably across Australia. As a result, capacity reserves are required if service is to be provided at acceptable quality levels. Furthermore, the progressive tightening by the Government of the minimum service standards set down through the system of Consumer Service Guarantees (“CSG’s), has increased the extent of the required reserves. This was an important factor ignored by the ACCC in coming to its conclusions.

Moreover, least cost provisioning over time requires that Telstra build its network ahead of demand. While accepting this in principle, the ACCC ignored the fact that this entails some costs that must ultimately be recovered. More specifically, the Commission simply deferred capacity costs to future periods, without then taking account of these deferred costs when those periods arrived. As a result, the ACCC’s modelling, even absent the other errors noted here, could not ensure full cost recovery for an efficient operator. This has obvious implications for the adequacy of Australia’s telecommunications network to serve future demand and again, reduces the incentives to invest both for Telstra and for its competitors.

48 Cribbet, P. 2000, Population Distribution and Telecommunications Costs, Productivity Commission Staff Research Paper, AusInfo, Canberra, August.

The allocation of shared trench costs

The ACCC has further reduced trench costs by proposing that costs be shared simply on the basis of the number of parties using the trench. If, for example, it is assumed three parties are using a particular trench, then costs are equally shared three ways, independent of how much of the trench each party uses.

This approach also ignores commercial realities and would appear to be simply used as a device to deflate access prices. Specifically, the ACCC ignores the basic economic principle that the costs should, as far as possible, be based on the willingness to pay for trench space by third parties or the opt-out costs of providing services by these parties. For example, if Telstra attempted to charge Foxtel at the level implied by the ACCC cost allocation method then Foxtel would in all likelihood have sought an alternative means of supplying PayTV (such as satellite or reliance on over-head cabling).

Depreciation

The ACCC has adopted an inappropriate depreciation profile which again deflates access prices.

The ACCC imposes competitive constraints on Telstra by allowing it to recover no more than it estimates would be possible in a competitive market. However, it then uses an annuity formula to levelise the competitive capital returns over the life of the PSTN assets, which results in a pattern of capital returns that would only occur in a competitive market if access seekers were willing to enter into long-term contracts with Telstra for access. Of course, the ACCC does not enter into any such regulatory agreement with Telstra and its actions discourage access seekers from doing so. Instead, the Commission is committed to frequent revisions of the access charge based on forward-looking costs. Therefore, it is completely inconsistent for the ACCC on the one hand to set conditions which make it impossible for Telstra to enter into long-term contracts and on the other hand levelise capital costs as if Telstra was in receipt of the certainty benefits of long-term contracting. Such an approach is out of line with the concept of economic depreciation – that the ACCC has itself endorsed – and with the Commission’s approach to the calculation of depreciation in other industries, most notably electricity.

The Weighted Average Cost of Capital

The ACCC has estimated a weighted average cost of capital of 10.4 per cent compared with Telstra’s estimation of 13.1 per cent. The lower estimate of the ACCC is a function of the different assumptions for components of the WACC.

One difference is that the ACCC uses a gearing of 40 per cent debt for PSTN despite a Telstra-wide market gearing of 10 per cent, implying an imprudently low gearing for the non-PSTN part of Telstra’s business.

Similarly, the ACCC has calculated an effective tax rate of 20 per cent, a rate derived by taking into account accelerated depreciation, which was abolished under the Ralph reforms.

Other differences relate to different assumptions for the appropriate risk-free rate of return, market risk premium, equity beta and debt risk premium. With regard to the risk free rate of return, for example, the ACCC chose to use a Government 2-year bond as the risk-free investment. One of the reasons Telstra disagrees with this choice is that there is a fundamental tension between levelising capital costs over the life of the relevant assets and adopting a (much) shorter maturity when calculating the WACC.

The allocation of IEN (Inter Exchange Network) costs to ISDN services

In its calculations, the ACCC unitises or distributes the total cost pool over PSTN and ISDN minutes on the basis that ISDN services use the same transmission and switching infrastructure as the PSTN. Unitisation over a wider sample of minutes substantially reduces the ACCC's unit cost estimates.

This approach is flawed because the TSLRIC model is supposed to reflect the cost of providing originating and terminating PSTN access on a forward-looking basis. ISDN is a different technology and an efficient operator rolling out a PSTN today would not provide ISDN services.

Even if it were correct to include ISDN, the ACCC has nonetheless implemented this incorrectly by failing to recognise the additional costs associated with providing a composite network. ISDN traffic has different characteristics to PSTN traffic with demand for this service concentrated in particular areas. In these areas, ISDN traffic has a significant impact on the switching and transmission resources required in the PSTN. It is inconsistent with elementary economic logic to include the additional minutes in the calculation without also taking account of the added costs.

The allocation of the access deficit

Finally, the allocation of the access deficit across traffic has a significant impact on the level of the interconnect charge.

The ACCC's approach to allocating the access deficit is arbitrary. The ACCC calculates the amount of the access deficit that would be allocated to interconnect traffic on the basis of minutes and then does the same calculation on the basis of calls. The ACCC then takes the simple average of this amount as the access deficit that should be recovered through interconnect charges. The ultimate result of its calculations is to allocate costs to Telstra's local calls in excess of the retail price-cap on local calls. This means that, despite the ACCC's acceptance of the principle that the access deficit needs to be recovered, it could never be fully recovered under the Commission's approach. Rather, the ACCC's approach involves the greatest part of that deficit falling on Telstra and Telstra alone. Such an approach is inconsistent with competitive neutrality, and with the provision of efficient investment signals.

Appendix E - Pricing the Local Carriage Service

The ACCC has consistently applied the TSLRIC pricing standard, discussed in Appendix D, to all declared services except the local carriage service (“**LCS”**). (The main service supplied under the LCS is local call resale, in which Telstra provides local calls at “wholesale” rates to competitors). In relation to LCS the ACCC, in developing its draft pricing principles, found that the TSLRIC of local call provision was above the capped retail price and hence that setting access prices for LCS at this level would provide Telstra’s competitors with “insufficient margin to compete”.

In taking this view, the ACCC ignored the fact that Telstra, when it supplies local calls, must incur the full costs that supply entails - and that access seekers must also face if competitive neutrality, and the efficient signals it sends, is to be secured. The ACCC also ignored the fact that, in the current market environment, the margin on the local calls *on its own* is not a relevant consideration, due to the widespread practice of selling local calls on a loss leading basis to attract STD, IDD and F2M revenues.

Setting this aside, however, in its draft pricing principles the ACCC has arbitrarily adopted a retail minus avoidable cost (“**RMAC”**) approach to setting the LCS access price. In doing so it has ignored the significant economic costs that accrue from setting access prices below the costs of service provision – to say nothing of the significant subsidy that Telstra shareholders would be in effect providing to Telstra’s competitors.

Appendix F - Critique of the ACCC's Draft Discussion Paper on the pricing of unconditioned local loop service (ULLS) charges

On 4 August 2000, the ACCC issued a pricing principles paper outlining its preliminary views on the pricing of the declared unconditioned local loop service and Telstra's proposed ULLS charges. In this paper, the Commission concluded that Telstra's proposed charges are well above those that the ACCC derived and are also high as compared to even the highest charges for ULL services in other jurisdictions.

While Telstra notes the Commission's qualifying statements in the report that its analysis is neither definitive nor binding, the publishing of such findings has a significant impact on commercial negotiations. In effect, access seekers now view these charges as the maximum possible charges for ULLS and are now concentrating efforts on pushing the Commission below these levels.

Telstra is particularly concerned by the effect of the ACCC's preliminary findings given the magnitude of the errors made by the ACCC in its calculation of ULLS charges. This misleading effect is further compounded by the ACCC's incorrect comparison of Telstra's proposed charges with those in other jurisdictions.

The purpose of this attachment is to identify the main errors and inconsistencies in the ACCC's analysis of ULLS pricing.

Exclusion of the access deficit contribution

In its paper, the ACCC concludes that it is not "disposed" to accept an access deficit contribution ("**ADC**") in the ULLS charge as it would mark a departure from past practice, may be contrary to the legislation and would have, at best, an ambiguous effect on telecommunications pricing. In each instance, the ACCC's analysis is plainly incorrect.

The only "past practice" where the ACCC has considered the access deficit contribution is in the case of PSTN interconnection charges. In this analysis the ACCC found that the access deficit was a cost common to the provision of all services, including access services, and hence should be included in the PSTN access charges. In fact, the ACCC concluded that to exclude the ADC would encourage inefficient entry, discourage efficient investment, prevent Telstra from recovering legitimate costs, result in Telstra under-investing in the network and create inefficient arbitrage opportunities. Given that access seekers using ULLS still use Telstra's PSTN, there is no justification for excluding the ADC from ULLS charges.

The ACCC then suggests that the ADC is a consequential cost as defined by the legislation and would therefore not be admissible under the direct-cost-only-rule. This suggestion is inconsistent with the Commission's past treatment of the ADC where it has specifically treated the access deficit as a common cost, not a consequential cost. In its final assessment of Telstra's PSTN undertaking, the Commission explicitly state that the ADC is not a consequential cost:

> The Commission understands that the reference to 'consequential costs' in the explanatory memorandum is a reference to a loss of monopoly rents that can occur as a result of increased competition in upstream or downstream markets. In its view, it may be appropriate to

> distinguish between the loss of monopoly rental and the loss of a contribution towards (efficient) line costs that occurs when Telstra loses an end-user to a competitor.[49]

On this basis the ACCC concludes that to "maintain competitive neutrality, it would seem to be legitimate for Telstra to recover an access deficit contribution through charges for the declared PSTN services".

The Commission next proposes that the ADC should be excluded from ULLS charges on the basis that the effect on telecommunications prices is ambiguous. While it is unclear why an ambiguous effect weighs against inclusion, the ACCC's conclusion is nonetheless wrong. Excluding the ADC from the ULLS charge does nothing to reduce the allocative efficiency loss associated with retail price controls as suggested by the ACCC, it merely shifts more of the burden associated with that loss to Telstra. Indeed, elementary economics suggests that, to the extent that it has the effect of forcing recovery of the loss on to a narrower income base, exclusion will increase the efficiency loss associated with the retail price controls. More generally, the exclusion of the ADC from the ULLS charge would result in a substantial increase in PSTN interconnection charges, thus encouraging inefficient use of the PSTN and ULLS access services.

Overall, the ACCC's proposed approach is inconsistent with well-accepted economic theory, which says that if a tax needs to be imposed on a good it should be imposed on all goods that are close substitutes. The ACCC's proposal to exclude the ADC from the ULLS charge is also inconsistent with its previous inclusion of the ADC in the PSTN access charges, would not remove the allocative inefficiencies associated with the retail price-cap on basic access, but would instead shift more of the associated burden to Telstra which would in turn be costly in terms of productive and allocative inefficiencies.

Errors in calculation of ULLS charges

The Commission indicated in its pricing principles paper that it had modified the NERA model to assess the impact of shifting from the optimised network architecture used for assessing PSTN access prices, to the architecture needed to actually support ULL. This in essence requires altering the number of remote traffic aggregation units in the network (RIMs and RSS/RSUs):

> …the NERA model has been adjusted to reduce the number of RIMs by 50 per cent and increased the number of RSS/RSUs as required to service those lines which were assumed to be served by RIMs.[50]

Commenting on the effect of implementing this approach the ACCC states that "in quantitative terms, however, this change has only a relatively minor effect on network costs".

49 ACCC 2000, A report on the assessment of Telstra's Undertaking for the Domestic PSTN Originating and Terminating Access services, July, section 7.3.2.

50 ACCC 2000, Pricing of unconditioned local loop services (ULLS) and review of Telstra's proposed ULLS charges, Draft Discussion Paper, Chapter 4 under heading Revised RSS/RSU and IRIM/RIM configuration.

In subsequent discussions with the ACCC it has indicated that these results were in fact generated by another, simpler method and that while it intends to do the NERA model adjustment described above, this has not yet been done. This being the case, Telstra is at a loss as to how the ACCC can conclude that the adjustment "has only a relatively minor effect on network costs".

Telstra has replicated the methodology actually used and found a number of serious errors in the approach, which the Commission has subsequently agreed are present. Of major concern, these errors bias the cost estimates downward, providing a false basis for the damaging conclusion published by the ACCC that Telstra has over priced ULL by a large amount.

The approach actually used by the Commission is as follows.

On the basis of Telstra's reconstruction of the results in the Commission's paper, the ACCC has simply used an arbitrary scaling factor to arrive at their proposed Band 2 and Band 3 network costs. To demonstrate why this approach is incorrect, consider their proposed ULLS charges for Band 2.

Telstra's understanding is that the ACCC has derived the Band 2 network costs of $222 per year based on the network costs it derived for Band 1 of $111 per year and the ratio of Telstra's proposed Band 1 and Band 2 charges. That is, the Commission translation of its PSTN cost estimates to a ULL cost estimate for Band 2 involves the following calculation:

ACCC Band 2 charge = ACCC Band 1 charge * (Telstra Band 1 charge / Telstra Band 2 charge)

or

ACCC Band 2 charge = $111 * ($548 / $272) = $222

On this basis the ACCC concludes that a reasonable Band 2 network charge is $222 compared with its NERA result of $293 per line (excluding line card) for metropolitan areas. This approach is clearly wrong. The costing of the network termination device (NTD) helps demonstrate why the ACCC's short-cut approach to calculating Band 2 and Band 3 charges is incorrect.

The costs of the NTD are excluded from the total network costs as calculated by the ACCC, accounting for approximately $20 per year (capital cost, installation and travel time and O&M expenses) of the $161 per year difference between the Commission's and Telstra's estimate of total network costs for Band 1. Because the cost of the NTD is the same across all bands, it should also account for a $20 per year reduction in network costs in Bands 2, 3 and 4. However, based on the ACCC's approach, the exclusion of the NTD accounts for a $40 per year reduction in costs for Band 2, simply because Telstra's total Band 2 network costs are double those in Band 1.

To demonstrate this more clearly, assume that the only difference between Telstra's proposed ULLS charges and the ACCC's proposed ULLS charges is the NTD cost of $20 in all geographic areas and Telstra's Band 2 charge is double its Band 1 charge. For illustrative purposes, assume that the ACCC's Band 1 network cost estimate is

$100 per line, Telstra's network costs in Band 1 are $120 and Telstra's network costs in Band 2 are $240. The ACCC's approach would produce a Band 2 charge of:

ACCC Band 2 charge = $100 * ($240 / $120) = $200

This is clearly incorrect, as the ACCC's Band 2 charge should have been $220 (ie $240 - $20) not $200.

The ACCC's approach would only be correct in the single case where costs in each band are linear - that is, if each network component made up the same proportion of total costs in each band. In the example above, it would require that the NTD cost account for 16.67% of total network costs in both Band 1 and Band 2. As this is clearly not the case, and would only be a coincidence if it did hold for any individual network component, the ACCC's approach is clearly incorrect for translating the NERA ESA based network costs to the line density based bands.

For Band 1, it is not clear why any adjustment is required for the number and geographic distribution of remote units as all services in CBD areas are RSS / RSU services. However, the ACCC appear to make some unexplained adjustment, or if they do not, then its arithmetic is incorrect.

This leaves Band 4 where ULL take-up will be insignificant. If the Commission has made the changes it claimed to in its report then the cost estimates presented in the ACCC's draft paper suggest that accounting for the number and geographic distribution of remote units in Band 4 increases network costs by $50 per year from $418 (rural line costs less line card) to $468.

This result is astonishing given that the majority of all rural customers are served by RIM technology and yet a corresponding adjustment apparently makes no difference to Band 2 and 3 network costs where the actual distribution of remote units is significantly different from that assumed in NERA. Rather, it appears that the charge for Band 4 was determined by working backwards to determine what charge would maintain the average across all areas constant.

In Telstra's view, the Commission's clearly inadequate analysis is unacceptable for a public assessment Telstra's ULLS charges. While Telstra does not agree with the approach used by the Commission in calculating ULLS charges, the Commission should at least be required to ensure that its calculations are robust.

International comparisons

The ACCC's ULLS pricing paper makes a comparison between Telstra's monthly ULLS charges and the monthly charges in a number of overseas jurisdictions. While the report acknowledges that these comparisons should be treated with caution, the Commission nevertheless draws on this comparison to conclude that Telstra's proposed ULLS prices are high when benchmarked against the comparison countries.

Telstra questions the value of this benchmarking as the charges used by the Commission are clearly not comparable. Most important, the ULLS monthly charges in a number of jurisdictions are quoted without even the most rudimentary adjustments for differences in the structure of charges, and different rates for once off and provisioning charges. In the absence of these adjustments, the comparisons presented by the Commission are at best of little value and are most likely to be misleading.

A comparison of Telstra's rates with British Telecoms' (BT) rates in the UK helps to illustrate this point. BT has a much higher connection charge than Telstra (£150 ($443) versus $105), as well as a disconnection charge of £20 when the ULLS is returned to the access seeker. The table below compares Telstra's and BT's network charges after making the appropriate adjustments for these differences in the structure of charges[51].

Comparison of Telstra and BT ULLS charges[1]

	British Telecom			**Telstra**	
Cost components	**Charge (£)**	**Annual equivalent (£)**	**Annual equivalent (A$)**	**Charge (A$)**	**Annual equivalent (A$)**
Connection charge[2]	150	75	193	105	52
Disconnection charge[3]	20	10	18		-
Monthly rental[4]		113	334		590
Total			544		643

Notes:

1 Based on exchange rate (£/$A) of 00.3386 and ULL contract period of 2 years

2 includes service qualification test

3 discounted by 2 years

4 network costs plus access deficit contribution

In addition to failing to take account of these differences, the ACCC also fails to make adjustments for Australian conditions. The most important of these is differences in line density, which Telstra has identified in a number of submissions in the context of the PSTN undertaking[52]. The recent Productivity Commission (2000) report[53] highlights the importance of line density as a major driver of differences in costs between countries. To quote directly from the report:

51 For the purposes of the comparison, the system set-up charges have been excluded. BT's total system set-up costs were £21.1m ($62.3m), and are recovered through a £2,509/100 pair cable charge.

52 See correspondence dated 16 June 1998 and 7 July 1998 and in a report prepared by CRA, The Effect of Subscriber Density on Access Costs. The CRA report was submitted to the ACCC on 30 September 1998.

53 Cribbet, P. 2000, Population Distribution and Telecommunications Costs, Productivity Commission Staff Research Paper, AusInfo, Canberra, August.

> "The average cost of providing local telephone services is increased in Australia, because it has a relatively large proportion of its population (and hence lines) in areas with low population densities"[54]

and

> "Depending on assumptions about the cost of providing each line, average line costs in low-density areas of Australia of less than about 2 lines per square kilometre were found to be between 6 and 10 times the average cost per line in the rest of Australia."[55]

Consideration of the Productivity Commission analysis indicates that Telstra's ULLS charges are not high when compared with the UK.

54 Ibid.

55 Ibid.

APPENDIX G: Australia Post's concerns with proposed Part XID of Trade Practices Act

Part XID of the Trade Practices Act containing an access regime for postal services, is proposed to be inserted by Schedule 4 to the *Postal Services Legislation Amendment Bill 2000* (**"Bill"**), currently before the Senate. The Bill was introduced to the House of Representatives on 6 April 2000 and was then referred to the Senate - Environment, Communications, Information Technology and the Arts Committee, which reported on 5 June 2000.[56]

The legislation was introduced in response to the National Competition Council's conclusion that the success of future competition in the postal services market would be dependent on adequate access arrangements.[57] The objective of the access regime, as outlined in the Explanatory Memorandum to the Bill, is:

> to generate further competition in the postal services market, and to have this competition flow through to the range of services offered to consumers, and the pricing of those services [and] to promote the long term interests of end users of postal services and to ensure that these services are supplied as efficiently and economically as possible… [58]

Currently, Australia Post provides access to its networks by offering:

- discounts to bulk mail customers who pre-sort mail, the discount based on the sorting costs avoided by Australia Post; and
- discounts to customers who interconnect bulk mail at Mail Centres, with discounts recognising the direct transport costs avoided by Australia Post.

In 1997 Australia Post submitted to the National Competition Council (**"NCC"**) review that these mechanisms were adequate as they provided effective and equitable access to Australia Post's networks, evidenced by the fact that no dispute had been notified to the ACCC. Further, Australia Post submitted that its networks would not satisfy the test for a mandated access regime under Part IIIA of the Act.[59] While the NCC accepted that it was unlikely that Post's networks would meet the tests for declaration under Part IIIA, it proposed that mandated access arrangements should be introduced.

In both the NCC review and the Senate Committee inquiry Australia Post proposed a less intrusive access regime. Australia Post proposed a regime under which it would offer access to competitors on the same terms and conditions as those offered to Australia Post's customers, with the ACCC only having a limited "watching" role.

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56 Report of the Senate Environment, Communications, Information Technology and the Arts Legislation Committee on the Postal Services Legislation Amendment Bill 2000, June 2000 ("Report").

57 NCC, Review of the Australian Postal Corporation Act 1989, pages 277-278 ("Review"), 1998.

58 Explanatory Memorandum, House of Representatives Postal Services Legislation Amendment Bill 2000 ("EM"), pages 2, 14.

59 Australia Post submission to the Senate Environment, Communications, Information Technology and the Arts Legislation Committee, 2 May 2000 ("Submission"), page 16.

As such the ACCC's role would be to ensure that competitors were not disadvantaged compared to Australia Post's customers, with the ACCC ruling on whether Australia Post was offering like prices and conditions for like lodgements of postal articles. Such a regime would not give the ACCC a "de novo" role on price setting which, it argued, could put reserved services revenue at risk. Australia Post argued that this regime could be accommodated within the Australian Postal Corporation Act 1989, rather than the Act, simply by amending section 32D to remove Australia Post's exemption from Part IIIA.[60]

The proposed Part XID regime differs from the general access regime in Part IIIA. Rather, the Bill proposes an access regime that is similar to the framework established by Part XIC. The Part XID regime includes:

- the deemed declaration of a number of services at the commencement of the regime;[61]
- the declaration of "postal services" by the ACCC, specifying a postal service provided by a particular provider;
- where agreement as to the terms and conditions of access are reached by means of commercial negotiation, the enforcement of registered agreements by the ACCC;
- where no agreement can be reached between the access seeker and the access provider, the notification of disputes to and the arbitration of disputes by the ACCC, resulting in a determination about the terms and conditions of access;
- access undertakings which take precedence over declarations, in contrast to the regime under Part IIIA in which the ACCC cannot accept an undertaking in relation to a declared service;
- record-keeping and disclosure rules, designed to assure competitors that Australia Post is not cross-subsidising from reserved services to services it provides in competition with other postal operators.

Proposed section 153C sets out the criteria for declaration. While they are largely similar to the criteria under Part XIC, section 153C(2) requires the ACCC to be satisfied that access will promote competition in at least competition in at least one market, other than the market for the service. A similar provision is present in Part IIIA of the TPA but is absent from Part XIC. This criterion recognises that the purpose of the access regime is to provide access only where access is necessary to allow an access seeker to gain entry into an upstream market, a downstream market or some other market.[62]

60 Submission, pages 17-18; and Robert Ludlow, Deputy Chief Executive Australia Post, Proof Committee Hansard, Canberra, 8 May 2000 ("Hansard"), page 76.

61 Based on the recommendations of the NCC's review, the Minister will declare Australia Post's bulk mail services and post office boxes

62 EM, page 49.

Another difference from Part XIC is that Part XID provides a right of review of the ACCC's decision to declare a postal service, with the Australian Competition Tribunal undertaking a reconsideration of the matter.[63] However, under Part XID the ACCC is not required to hold a public inquiry before declaring a postal service, which has been criticised by the National Farmers Federation.[64]

In discussing the proposed regime in contrast with Australia Post's preferred system before the Senate Committee, Australia Post emphasised that it is most concerned about the ACCC having 2 broad powers:

- power to determine what a postal service was; and
- power to determine prices.[65]

Australia Post's fundamental concern with the access regime is that it should not put at risk revenues and margins for reserved service (bulk) mail which are used to fund CSOs.[66] This sentiment was supported by the Labor Senators' minority report, which concluded that :

> [while] an appropriate postal network access regime can be part of a healthy competitive industry…[it] must not be to the detriment of the notion of universal access to reliable and dependable postal service standards.[67]

Australia Post identified the potential risk that the ACCC would set prices:

- with insufficient regard to Australia Post's CSO obligations and costs; and
- which were not based on costs directly avoided by Australia Post in providing access.

Also, Australia Post was concerned that the ACCC would have insufficient regard to Australia Post's need to generate an adequate return on the infrastructure involved in providing the services that were being accessed.[68]

Australia Post highlighted the potential effect of the uncertainty as to how the ACCC will operate within the framework of proposed Part XID. Australia Post estimates a revenue and profit loss of $25m to $30m for every cent the ACCC reduces the price.[69]

63 Proposed section 153F.

64 See proposed section 153C(4) and National Farmers Federation, Submission to the Senate Environment, Communications, Information Technology and the Arts Legislation Committee, 28 April 2000, page 2.

65 Robert Ludlow, Deputy Chief Executive Australia Post, Hansard, page 76.

66 Submission, page 17. Australia Post's CSOs are set out in section 27 of the Australian Postal Corporation Act 1989.

67 Report, page 38. See also the Australian Democrats objections to the access regime, based on its concern for the preservation of CSOs: Report, pages 43 - 46.

68 Submission, page 18.

69 Cordell Short, Chief Finance Officer Australia Post, Hansard, page 68.

Australia Post emphasies that the effect of the access regime on all participants is the largest unknown resulting from the legislation, especially as no methodology has been prescribed for the ACCC to determine access prices by.[70] As such, Australia Post has indicated that it will be "robust in representing its case to the ACCC to minimise revenue and margin losses".[71]

However, Australia Post recognised that the Act does require the ACCC to "have regard to" different criteria in deciding to declare a service and in making an access determination which may reduce that risk. Relevantly, the criteria include Australia Post's legitimate business interests and investment in a facility, any reductions in costs and the need for Australia Post to recover the cost of performing its CSOs as reducing the risk that the access regime would operate to the detriment of Australia Post's profitability, and its ability to meet its reinvestment needs.[72] Further, the Explanatory Memorandum states that in having regard to these criteria, it is "expected" that the ACCC will take into account the need for access providers to make "normal commercial returns on investment over time". It also notes that while the costing methodology is at the ACCC's discretion, it is required to take account of any direct costs incurred by the access provider, as well as any savings which the access provider might make because of functions which would otherwise have been performed by the access provider.[73]

As explained by Senator Peter McGauran in the second reading speech of the Bill:

> It is not the intention of [the objectives of the Bill] that the access regime should operate in any way to put at risk Australia Post's community service obligations or the viability of Australia Post's infrastructure.[74]

The Senate Committee has recommended that Schedule 4 of the Bill be amended to limit the ACCC's role to those instances in which Australia Post fails to reach a negotiated agreement with a competitor in relation to fair access.[75]

In drafting proposed Part XID, the government appears to have adopted many of the changes that Telstra has argued are required in Part XIC, including: the right of appeal from the ACCC's decision to declare a service; the the requirement that only "bottleneck" services be declared; and the requirement that declaration may only occur if competition will be promoted in a market other than a market for the service in issue.

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70 Hansard, pages 73, 74, 77, 78, 81-82.

71 Submission, page 4.

72 Submission, pages 18-19.

73 EM, pages 59-60.

74 Senator Peter McGauran, second reading speech Postal Services Legislation Amendment Bill 2000, 6 April 2000. See also the submission by the Department of Communications, Information Technology and the Arts to the to the Senate Environment, Communications, Information Technology and the Arts Legislation Committee, 2 May 2000, page 6.

75 Report of the Senate Environment, Communications, Information Technology and the Arts Legislation Committee on the Postal Services Legislation amendment Bill 2000, June 2000, p 2 ("Report").

APPENDIX H: methodology for determining access prices

1) In assessing the reasonableness of an access undertaking under subsection 152BV(2)(d), or in making a determination under subsection 152CP(1) or 152CPA(1), the Commission must be satisfied that an access provider will be able to recoup its actual costs of providing access to the declared service, those costs including:

a) in the case of investment incurred on or before 30 June 1997 – optimised replacement costs adjusted for depreciation; and

b) in the case of investment incurred after July 1997, actual costs adjusted for depreciation, so long as these are not demonstrated to be inefficient relative to expectations which were reasonably held at the time of investment.

2) In assessing the reasonableness of an access undertaking under subsection 152BV(2)(d), or in making a determination under subsection 152CP(1) or 152CPA(1), the Commission must, in addition to the matters in subsection (1), take the following matters into account:

a) the need for the access provider to recover the actual costs incurred in meeting any universal service obligations or community service obligations and service standards, from access seekers and end-users, so long as the actual costs are not demonstrated to be inefficient relative to expectations which were reasonably held at the time of investment;

b) the interests of all persons who have rights to use the declared service;

c) the impact of any proposed pricing of access to the declared service on:

i) carriage and content services based competition having regard to the ability of acquirers to compete in dependent markets; and

ii) facilities based competition in relation to the provision of the declared service;

d) the economically efficient operation of the existing declared service, or a facility used to provide the declared service; and

e) the nature of any access or relevant arrangements between the access provider and the access seeker including:

i) the duration of any such agreements;

ii) any volume commitments provided by the access seeker; and

iii) other terms and conditions which might reasonably be reflected in pricing, including but not limited to any risk sharing factors.

3) Subject to subsection (4), subsections (1) and (2) are intended to limit the matters to which regard may be had. In taking into account the matters listed in subsections (1) and (2), the Commission must:

a) specify:

i) the incremental cost of providing the declared service;

ii) the stand-alone cost of providing the declared service; and

b) where the declared service subject to the determination has common facilities costs with other services, ensure that:

i) none of the declared services are priced at levels which fail to recover the incremental cost applying to them;

ii) no grouping of these services are priced so as to recover group revenues which exceed the stand-alone cost of the minimum actual facilities required to provide them, including a reasonable risk-weighted cost of capital; and

iii) taken together, all services recover the costs their provision entails.

4) If the Commission elects to take into account any matter other than a matter listed in subsections (1) or (2), it must:

a) demonstrate that there is an unequivocal public benefit achieved by so doing; and

b) give reasons for considering that other matter.

5) For the purposes of this section, an **access provider** is:

a) a carrier or carriage service provider which supplies a declared service, either to itself or to other persons; or

b) a carrier or carriage service provider which gives to the Commission an access undertaking under Division 5 of Part XIC in relation to a declared service.

The objectives of these proposed pricing principles are as follows:

Subsection 1

The overarching aim of subsection 1 is to ensure that there is adequate recognition of, and recovery of, actual costs in the ACCC's pricing determinations. A critical element of the cost of providing service is the depreciation and return on asset values, both of which are driven by the choice of asset valuation method. For that reason, the proposed pricing principles distinguish between investments made before and after 1 July 1997.

The purpose of point 1b) is to ensure that access prices determined by the ACCC reflect actual costs of investment adjusted for depreciation, operating and maintaining plant put in place after 1 July 1997, as well as other costs of providing service. From this time there has been open entry to the telecommunications industry, bringing to bear market discipline on investment decisions. Nonetheless if operations can be demonstrated to be excessively costly relative to accepted best practices technology, network dimensioning requirements and operating practices at the time investments take place, actual costs should not be used. Rather the costs used should reflect a reasonable view on efficient service provision at the time relevant investments was made.

For investments prior to 1 July 1997 (point 1a), the relevant valuation metric is the well known regulatory measure of Depreciated Optimised Replacement Cost ("**DORC"**), which reflects service provision from best in use current technology. This choice is motivated by the recognition that prior to the introduction of full competition, some investment choices may have been sub-optimal.

Subsection 2

Subsection 2 identifies the matters to which the ACCC must have regard in determining the price of a service under subsection 1.

The purpose of point 2a) is to ensure that unfunded financial burdens placed on a service provider by any universal service or community service obligations are treated as an underlying cost and as such are adequately reflected in regulated access charges. This ensures competitive neutrality. Point 2a) also insures that the cost of meeting any particular service standard requirements mandated by Government is reflected in the ACCC's consideration of access charges. Finally, the only grounds for deviating from actual costs in considering access charges is when these costs can be demonstrated to be excessive (eg. inappropriate choice of technology, network "gold plating", over-staffing etc). In this case the costs used should reflect a reasonable view on efficient service provision at the time relevant investments were made.

The purpose of point 2b) is to ensure that the interests of access seekers are considered in assessing or setting regulated access charges.

The purpose of point 2c) is to ensure the Commission considers the implications for both services competition (competition between resellers) and facilities competition (competition among facility owners) in assessing or setting access charges. The motivation for making these points explicit is that current regulatory practice tends to favour unduly the interests of resellers at the expense of facility owners.

The ACCC's stated aim is to encourage entry by new competitors who will at first only be resellers, but who are expected to progress eventually to invest in facilities. The problem with this approach is that by favouring resellers in access pricing decisions, the ACCC is strongly discouraging facility investment. This outcome is arguably inconsistent with subsection 152 AB(2) of the Act, which states that the Commission must consider the extent to which declaration is likely to result in, inter alia, encouraging the economically efficient investment in the infrastructure by which carriage services are supplied. However the ACCC is currently given only vague and indirect guidance as to how it must respect the objective of encouraging economically efficient investment. Point 2c), along with other points in these pricing principles, is intended to make the necessity of respecting this objective more explicit.

The purpose of point 2d) is to focus ACCC attention on the need for efficient use of declared services. This would encompass, for example, the need to ensure that inefficient service providers (whether they be access seekers or incumbents) are not given preferential access to declared services over more efficient service providers.

The purpose of point 2e) is to make explicit in the ACCC's consideration of pricing determinations an ability to allow prices to vary reflecting risk sharing through different contractual options.

Subsection 3

The purpose of point 3a) is oblige the Commission to explicitly calculate and provide the cost amounts that set the floor (incremental cost) and ceiling (stand-alone cost) of the declared service. This is necessary to ensure that the Commission's price determinations do not fall outside these limits. It is strongly suspected that some of the Commission's recent price determinations have been below the incremental cost floor.

The purpose of point 3b) is to allow the service provider discretion as to the amount of the costs of common facilities (ie. facilities used in the provision of more than one service) that is recovered from any one of the declared services jointly using this facility. Point 3bi) is to ensure that no service or grouping of services is priced below the costs that would be avoided if this service was not provided. Point 3bii) is to ensure that no service or grouping of services is priced above its stand-alone cost of provision so that in total there is no over-recovery of common costs. This allows for efficient pricing from each service recovering its incremental costs and appropriate discretion allowed to recover common costs from those service for which demand elasticity (ie. price responsiveness) is lowest. Including a reasonable risk-weighted cost of capital ensures that revenues will be sufficient to maintain the asset base. Point 3biii) is designed to ensure that there is no under-recovery of costs.

Subsection 4

While it is not the intention to limit the range of matters which the ACCC may take into account to those listed in subsections (1) or (2), it is considered important that when the ACCC does elect to take other matters into account it is obliged to present evidence that there is a clear overall public benefit from the decision based on these considerations; and that the reasons for taking these considerations into account in these particular circumstances are clearly spelled out. With this requirement, there will be grounds to appeal any ACCC decision which places significant emphasis on unexpected or non-standard considerations.

Subsection 5

An <u>access provider</u> should be defined in a way that is consistent with the use of the term in Part XIC. Access provider is not defined in Part XIC, but reference is made to the provision of a declared service by a carrier or carriage service provider.

Appendix I: Investigations carried out by ACCC against Telstra under Part XIB

Investigation	Outcome under Part XIB	Cost imposed by Part XIB	Other avenues absent Part XIB
DC continuity	• ACCC alleged that Telstra was engaging in anti-competitive conduct under Part XIB but issued no competition notices with the implication that there was no likely or actual breach of Part XIB. • A section 155 notice was issued requiring data to be produced throughout the investigation. • Voluntary safeguard period implemented.	• Immediate disruption to network modernisation rollout. • Conservative approach to future network modernisation. • Substantial administrative burden.	• Similar to the Part XIB case, the ACCC may have argued that this conduct was in breach of s 46 by preventing or deterring other service providers from engaging in competitive conduct in the market for supply of data services. • However, it is unlikely that a claim under this section would have succeeded. • Interlocutory injunction (if supported by a court).
SPC	• ACCC threatened to commence action under Part XIB if Telstra did not continue to provide SPCs as an element of its ISDN service, but issued no Competition Notice. • Four months after the investigation commenced, the ACCC announced a declaration inquiry under Part XIC into ISDN and other data services.	• Administrative costs of replying to a series of detailed requests by the ACCC for information from Telstra. • Inefficiency costs of being required to continue to provide SPCs to users, even though Telstra had made it clear that the future of the service was not assured.	• It seems unlikely that the ACCC would have been able to make out a case under section 45 or section 46.
Vendor cabling / provisioning	• No competition notices issued under Part XIB, nor RKRs or section 155 notices. Information was provided by Telstra voluntarily and based on this data, there were not grounds to satisfy a breach of Part XIB. • Voluntary introduction of Vendor Provisioning Group	• Substantial administrative burden.	• Although section 46 deals with misuse of market power, the statistics provided by Telstra established that there was no misuse of market power so section 46 would not have been satisfied. The ACCC ceased its investigation when it realised Telstra was not engaging in anti-competitive conduct.
Commercial Churn	• Six Competition Notices were issued and proceedings commenced under Part XIB. The litigation was abandoned	• Market inefficiencies from below cost churn prices - too much churn.	• ACCC's allegations against Telstra included: unreasonable charges, slow processes and

Investigation	Outcome under Part XIB	Cost imposed by Part XIB	Other avenues absent Part XIB
	by the ACCC after a settlement agreement (favourable to Telstra, with no admission of liability) was reached. Unlikely that ACCC would have been able to establish a breach of Part XIB had litigation proceeded as Telstra was already charging conservative prices well below the actual costs of providing the services and such behaviour is clearly not a misuse of market power. • Telstra voluntarily reduced churn charges	• Very high legal/admin cost.	service providers being forced to assume liability for debts unbilled at date of transfer. • ACCC could have argued a breach of section 46 for misuse of market power or under section 45 for the effect of substantially lessening competition. • Interlocutory injunction (if supported by a court).
• STD $3 deal	• ACCC alleged that Telstra's was engaged in a price squeeze. Investigations by the ACCC revealed that a wholesale competitor (who had complained about Telstra's wholesale prices) was still charging retail prices below Telstra's rates. • Even if Telstra were found to have market power, then there was no evidence to show that Telstra's conduct caused a substantial lessening of competition or any damage to a competitor. • ACCC ceased investigation after 15 months, with no decision that Telstra had misused its market power • No competition notices issued under Part XIB. Implication is that ACCC was not able to find a breach of Part XIB.	• Ongoing conservative pricing by Telstra – market follower rather than leader. • Move to flat rate interconnection charges in order to alleviate the threat of the ACCC issuing a Competition Notice. • Substantial administrative burden.	• While the ACCC could have taken action under either section 46 or section 45, it is unlikely that the ACCC would have been able to make out a case under either provision.
• Internet Peering	• ACCC made allegations that Telstra was breaching the competition rule and behaving anti-competitively by requiring that its Internet Access Provider Customers (IAPs) pay for certain services received from Telstra, while Telstra did not pay the IAPs for similar services obtained from them.	• The result was a series of non-optimal agreements and arrangements with IAPs, who were not offering comparable networks or network traffic to be regarded as a 'peer' of Telstra.	• As per the STD deal above, it is unlikely that the behaviour was actually anti-competitive so as to breach either section 45 or section 46.

Investigation	Outcome under Part XIB	Cost imposed by Part XIB	Other avenues absent Part XIB
	• Two competition notices were issued in relation to this matter, but both were withdrawn. The initial notice was replaced with an amended notice but this was later withdrawn after peering agreements were finalised with several IAPs. Telstra never conceded that its conduct may have been in breach of Part XIB, rather it commenced negotiations as a result of the ACCC's threats to continue to issue competition notices.		
• CDNO	• ACCC commenced investigation into Telstra's behaviour, alleging that Telstra was acting anti-competitively by requiring that ISPs not use this service for anything other than the temporary diversion of phone calls when changing numbers. • Voluntary safeguard period for rural ISPs implemented.	• Investigation is current but on hold while safeguard procedures in place (until February 2001). • Inappropriate, non-commercial use of this service extended for 12 months.	• Telstra does not believe that the ACCC would be able to prove any allegation under Part IV, as Telstra is simply endeavouring to maintain the integrity of its network.
• Tritel/Payphones	• ACCC responded to complaint by Tritel in relation to pay phones. Allegations that Telstra using its market power by forcing Tritel to pay retail rates, Tritel not allowed to participate in smartcard venture and not compensating Tritel for calls made on their phones to Telstra 1800 numbers and not allowing Telstra phonecards to be used in Tritel payphones • Investigation discontinued at this stage, with no sign of competition notices being issued under Part XIB. • ACCC would need to establish that Telstra is taking advantage of its market power with the effect, or likely effect of lessening competition in that or any	• Investigation suspended following agreements by Telstra to manage Tritel through its wholesale area; to negotiate a lower price for local calls; and to consider the issue of compensation to service providers who transmit free- to-caller calls. • Substantial administrative burden imposed upon Telstra in responding to ACCC questions. • Brand damage from adverse publicity as a result of ACCC press release.	• ACCC issued press release stating that Telstra was dominant in the market for payphones. Given this conclusion, the ACCC could have pursued an action under section 46.

Investigation	Outcome under Part XIB	Cost imposed by Part XIB	Other avenues absent Part XIB
	other telecommunications market		
Switchports	• The issue here was complaints by PowerTel and One.Tel about Telstra's refusal to supply the number of switchports submitted as forecasted by the complainants. • No competition notices issued and formal recognition through an ACCC media release that Telstra not breaching the competition rule. • Outcome vindicated by subsequent major downward revision of switchport requirements by aggrieved parties.	• Brand damage from adverse publicity by ACCC despite its admission of no breach.	• There are arguably no provisions of Part IV that would be satisfied because Telstra was able to establish that it was not misusing its market power. If anything, the complainants were over-inflating their forecasts substantially.
ULL	• No formal investigation at this stage, but one RKR issued under Part XIB and another has been foreshadowed. • No competition notices issued and it appears that ACCC would not even have a reason to suspect anti-competitive conduct given the absence of formal complaints regarding provision of this service.	• Issue appears to be a concern that Telstra may be provisioning for itself ahead of external access seekers. Telstra, however, has no clear indication of the extent or nature of the ACCC's concerns in this matter. • Delay and extreme conservatism in Telstra's broadband rollout program. • Significant regulatory and administrative burden.	• Section IV not applicable without some formal complaint and/or evidence about Telstra's alleged anti-competitive conduct. Even then, the complaint has to be substantiated.