

**Competitive  
Carriers'  
Coalition**

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**September 7, 2005**

Submission to the Senate Environment, Communications, IT and  
the Arts Legislative Committee

Submission to the Inquiry into the Telstra (Transition to Full  
Private ownership) Bill 2005 and related bills

## **Introduction**

The CCC is an industry association representing the interests of non-dominant telecommunications carriers in Australia. Its members have collectively invested well over \$4 billion in competitive infrastructure in Australia. Its members compete in the retail, wholesale, fixed line, wireless mobile and fixed, residential, corporate, government, metropolitan and non-metropolitan markets.

The CCC welcomes the opportunity to comment on these important Bills.

## **Operational Separation**

The CCC welcomes the Government's commitment to addressing the structural impediments to competition in Australian telecommunications markets. The CCC has made numerous submissions to the Department of Communications through the course of 2005 presenting proposals for addressing these issues as part of the processes that led to the Bills presently before the Committee.

However, the CCC believes that the premise on which the Department constructed its model of operational separation after this consultation period is no longer valid.

The CCC understands that the model of operational separation proposed by the Australian Competition and Consumer Commission (ACCC), which would have required a simple division of Telstra into wholesale and retail groups, was rejected on the basis that there was a high implementation risk attached to that approach. It was suggested that this would take too long to implement.

The alternative approach developed by the Department was predicated on a low implementation risk because it reflected the existing internal arrangements of Telstra's business. The proposed arrangements were developed in discussion with Telstra.

In short, the proposal was to enshrine in legislation and regulation the present Network-Wholesale-Retail activities within Telstra's organizational structure. This structure is to underpin arrangements to establish benchmarks to ensure equivalence and transparency between the access and price arrangements that Telstra offers access seekers and provides itself.

However, the new management of Telstra has clearly and repeatedly signaled, both publicly and privately, that it intends to significantly restructure and reorganize the business. In particular, Telstra appears intent on significantly winding back its wholesale activities.<sup>1</sup>

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<sup>1</sup>Sol opens the curtain on fight for survival, Alan Kohler, SMH September 7 2005  
<http://www.smh.com.au/news/alan-kohler/sol-opens-curtain-on-fight-for-survival/2005/09/06/1125772521527.html#>

The CCC submits that it is crucial to understand that such a proposal for internal reorganization is in effect a plan to radically restructure the whole telecommunications sector. This is because Telstra continues to be vertically integrated such that it owns and controls the monopoly bottleneck elements of the network, most importantly the customer access network. It is also the most horizontally integrated telecommunications company in the world, according to the ACCC.

Telstra's integration creates a powerful incentive and the ability for it to leverage the market power it derives from this monopoly asset ownership in such a way as to disadvantage competitors in retail markets. This is the concern that was raised by the ACCC, the CCC and many others in recent years, and which led to the Government's proposals to introduce operational separation.

However, if Telstra no longer wishes to be organized in a way that is consistent with the operational separation proposal developed by the Department and Telstra, there is no incentive on Telstra to comply with the arrangements (See Box 1). Rather, the fundamental incentive for Telstra to disadvantage competitors remains. The regime relies on the ability of the regime to allow the ACCC to identify anticompetitive conduct by Telstra and apply an appropriate sanction.

In other words, the Telstra change of heart in recent months mean the proposed arrangements must rely on creating disincentives rather than incentives for Telstra to act in ways consistent with Government policy.

The disincentives are primarily built on the fines that would apply for a breach of the competition rule by Telstra. The CCC submits that the increase in the maximum daily fine only after a competition notice has been in place for 21 days is, in practice, meaningless.

The ACCC has indicated to a Senate committee that it does not believe that a court would ever apply the maximum fine, and that it would find it difficult to successfully mount a case under the competition notice arrangements under any circumstances.

By contrast, the model proposed by the ACCC for a simple retail/wholesale division was designed to allow a durable and robust wholesale business to be conducted which would, over time, increasingly respond to its own set of incentives based on market signals. This is a wholly different approach to regulation. It relies on incentives that are aligned with Government competition policy, not on an onerous set of compliance obligations and penalties. This is because it would align fundamental commercial incentives with desirable market conduct. In the present environment, the model preferred by the Department and reflected in the present Bills would inevitably lead to ever increasingly regulation, where the ACCC proposal would create incentive that should allow for gradually reduced regulation.

The CCC urges the Government to reconsider the proposed model of operational separation in the light of the changed internal organization of Telstra signaled by its new management, and the aggressive anti-regulation stance that the management has taken. If this is not possible, the CCC believes that the Government should amend the requirement in this legislation at Section 61A for an inquiry into telecommunications competition. This requirement should specify that the Productivity Commission conduct a full inquiry into the state of competition in Australian telecommunications in three years. This would create a discipline on Telstra to implement the arrangements as intended. This inquiry should be tasked with recommending what further action is required to address effectively structural impediments to competition, and it should be able to consider arguments for structural separation as part of these deliberations. The CCC has repeatedly noted that the successful negotiations in the UK between Ofcom and BT was underpinned by the ability of Ofcom to recommend an inquiry into structural separation if BT did not act in good faith. A similar discipline could be put in place by amending the Bill as proposed above.

### **Designated Services**

The Government has recognized that there are services that have not been declared, but which need to be embraced by the operational separation framework, both on price and non-price terms and conditions, in the interests of effective competition. An example of this is likely to be wholesale ADSL, which was the subject of a competition notice for nine months to February 2005.

However, the legislation does not allow for new services that are regulated by the ACCC through actions to ensure compliance with the competition rule to be designated by the Minister. Rather, it provides for Telstra to be provided with an effective veto on the Minister by requiring the Minister to seek and receive the written consent of Telstra.

The CCC submits that the Minister should be able to act on the advice of the ACCC to add new services to the list of designated services.

This is particularly important in the context of Telstra's clear public indications in recent weeks that it will seek to introduce new services delivered through its bottleneck infrastructure without providing wholesale access.

### **Telstra's Plan for Re-Monopolization of Australian Telecommunications**

The "Digital Compact and National Broadband Plan" presented by Telstra to the Government on August 11, 2005 and released publicly on September 7, 2005 provides a clear insight into Telstra's fundamental motivation and plans for the future.

In short, Telstra has presented a plan that would result in the re-monopolisation of telecommunications in Australia. Despite the Government's rejection of the proposal that taxpayers fund this ambition, it can be expected that the strategy signaled in the document will be pursued by Telstra anyway.

There are two prongs to Telstra's plan to achieve this end. The first is to deny access to the bottleneck elements of its network through seeking exemptions from access laws. If it is unable to achieve access holidays, Telstra can be expected to delay the application of these laws by gaming the processes to declare them as subject to access requirements, and then by setting prices for access that were unreasonable.

The second element of Telstra's plan signaled in the August 11 document is an attempt to raise the price of access to existing declared services, notably the unbundled local loop. It is seeking to do this by arguing that wholesale access prices should be averaged across the country. This is a reversal of the position taken by both Telstra and the ACCC since this service was first declared. Such a change would have the effect of making this service uncompetitively priced, and remove the most important point of competitive pressure on Telstra in the present environment.

If Telstra succeeds in denying access to elements of its network as they are modernized and making the pricing of ULL uncompetitive, competition in telecommunications would be doomed.

## **Regulatory Arrangements and Uncertainty**

The CCC is concerned that the Bill creates a regulatory environment where the Minister becomes responsible for making decisions that would be expected to be the responsibility of the independent regulator.

This relates not only to the processes that will be used to implement the reference prices and operational separation plan, but to the arrangements that will be in place on an on-going basis.

Further, the Bill does not specify the criteria upon which these decisions will be made in the future, or the processes that will be followed before reaching them.

This is an arrangement that is of extreme concern to the CCC as it creates an environment of great uncertainty. It is not clear whether the Minister or any future Minister will be required to follow a public process before making changes to the price or non-price elements of the regulatory package presently being put in place. This would include decision-making around the inclusion of new services, decisions that are likely to be both crucial to competition and strongly resisted by Telstra.

This lack of clarity creates a level of uncertainty and a potential confusion of regulatory roles that has not existed in telecommunications industries since the introduction of competition. Such uncertainty has the potential to be a powerful disincentive to investment.

An example of the type of issue that is not dealt with in the legislation as it stands is the management of determining access arrangements to bottleneck infrastructure where Telstra modernizes parts of its network. For example, Telstra has now acknowledged that it has seriously neglected investment in the network in recent years. This means it has no choice but to put in place investment plans that will remediate the problems that have emerged because of its failure to invest sufficiently in the past.

It is likely that the deficiencies around these processes will become apparent in the next few months.

## **Process Concerns**

The Bill places responsibility for the development of an operational separation plan primarily with Telstra. As discussed above, the CCC does not believe that Telstra can be expected to present a proposal that would be credible in circumstances where it has indicated that it plans to wind back its wholesale activities.

Further, the CCC understands that those wishing to comment on the Telstra proposal would be required to provide its comments to Telstra, and that Telstra would be responsible for considering the comments and taking them into account in its final draft.

The CCC submits that it is fanciful to believe that Telstra would give proper regard to the comments of competitors. Further, there is no formal mechanism whereby those submitting comments to the Telstra plan can present those comments to the ACCC and the Minister and be sure that they will receive proper consideration and that valid criticisms of the Telstra plan contained therein will be incorporated in changes required by the Minister.

The CCC believes that there should be a process that gives stakeholders clear guidance as and comfort that their comments will be formally considered by the Minister and the ACCC before any operational separation plan is finalized.

### **Changes to the LTIE Test**

The CCC is concerned that the proposed amendment to the way in which the long-term interests of end-users (LTIE) test is to be applied and interpreted by the ACCC could have the consequence of increasing access prices to Telstra's existing network.

The CCC understands that the proposed amendment was intended simply to clarify that the ACCC should have regard to risks associated with new or proposed investments when considering undertakings or declaration processes. However, the CCC is concerned that the amendments create an opportunity for Telstra to claim a surcharge on access prices on existing services delivered over the PSTN network. The CCC believes Telstra is likely to argue that this amendment can be interpreted to allow it to recover these additional costs under the so-called "real options" theory.

The CCC believes that this would be an illegitimate use of the theory, which is controversial in itself. However, as discussed above, Telstra can be expected to continue its historical practice of gaming regulatory processes to delay access and create market uncertainty, and the amendment as presently drafted would create a further opportunity for it to pursue this strategy.

### **Conclusion**

The CCC is gravely concerned that there has been insufficient time for the Bills to be properly considered. That these Bills are being presented at a time when Telstra's management has indicated a determination to wind back and avoid regulation adds to the risk associated with passing legislation that has not been fully considered.

The CCC hopes that there will be a further opportunity to consider these Bills and would welcome the opportunity to contribute.

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