Chapter 4

Access

> What I see is that you have this network there that Telstra has already built and it is there serving the community. Why can't the other carriers have access at a fair price to that same infrastructure? Why go and duplicate it? It is crazy economics. If it is there and it is in the ground, why not let them have access to it but at a good price?[1]

Introduction

4.1 A firm that wants to provide telecommunications services can do so either by accessing existing upstream services or infrastructure or by investing in its own infrastructure, which must then interconnect with or access other networks.

4.2 There are barriers to both courses of action, however. The magnitude of the costs of building alternative infrastructure can operate as a significant impediment. This is particularly so in relation to certain parts of the network like Telstra's ubiquitous local access network which is commonly regarded as a natural monopoly.

4.3 Although there has been some alternative deployment of infrastructure at this level—and the limited potential for technology to enable more—it remains true that those seeking to compete with Telstra (as an owner of a bottleneck facility) must, at a minimum, rely on some sort of access to Telstra's local access network.

4.4 Without regulation, there is little incentive for an infrastructure owner to provide third party access to its network. Further, even when obligations to provide access exist, infrastructure providers have an incentive to frustrate access on equal terms. This may result in the owner discriminating in favour of its downstream business, delaying access or permitting access on uncommercial terms. As one witness observed, 'Why would a fully commercial operation want to open up a world-class network for their competitors to use?'.[2]

4.5 The Hilmer Report on national competition policy observed:

> … where the owner of the "essential facility" is vertically-integrated with potentially competitive activities in upstream or downstream markets – as is commonly the case with traditional public monopolies such as telecommunications, electricity and rail – the potential to charge monopoly

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1 Mr Gary Chappell, Peel Development Commission, *Committee Hansard*, 29 April 2005, p. 73.

2 Mr Christopher Hill, WA Local Government Association, *Committee Hansard*, 29 April 2005, p. 14.

> prices may be combined with an incentive to inhibit competitors' access to the facility.[3]

4.6 It is because of this tendency that access regimes have been implemented in previously vertically integrated infrastructure industries such as telecommunications, gas, electricity and rail.

The legislative framework

4.7 As outlined in Chapter 2, Part XIC of the TPA sets out the access regime in relation to the telecommunications industry. The regime was intended to work alongside the sanctions for anti-competitive conduct in Part XIB. The regime requires owners of monopoly elements of what is generally the former public network to give access to wholesale customers on equitable and competitive terms.

4.8 A key monopoly element is the local fixed network. In fact, the ownership by Telstra of the local loop was identified by the Productivity Commission in 2001 as the 'single most important factor underlying the need for regulation in telecommunications'.[4] Although it was once thought that the copper network would dwindle in importance due to the development of competing technologies such as wireless, it is now, perhaps, more important than ever because of advances in copper-based DSL technologies that are increasingly capable of extracting higher speeds out of the network.

The policy intention

4.9 The policy intention behind the access regime was that it would enable competing service providers to make effective decisions about whether to invest in facilities or buy services from existing providers. The downstream service providers which can build a customer base and a profitable business might then be in a position to contemplate investing in infrastructure. The development of alternative infrastructure and effective facilities-based competition would, in turn, reduce the need for access regulation because competitive alternative sources of upstream services would provide a commercial incentive for negotiated access.

4.10 Part XIC, therefore, purports to underpin the goal of promoting services-based competition, at least in the short term, while encouraging efficient facilities-based competition in the longer term. Competition at the facilities level should in turn reduce the need for access regulation over time.

4.11 The legislation expressly sets out this aim in section 152AB. The object of Part XIC is to promote the long-term interests of end users. In determining whether a

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3 Independent Committee of Inquiry into National Competition Policy, *National Competition Policy – Report by the Independent Committee of Inquiry*, AGPS, Canberra, 1993, pp 240-241.

4 Productivity Commission, *Telecommunications Competition Regulation*, Report No. 16, 2001, p. xxiii.

particular activity does so, regard must be had to the objective of encouraging the economically efficient use of, and investment in, infrastructure to promote competitive service delivery in the markets for listed services.[5] Competition in the services market – and the attendant drive for innovation, lower prices and better customer service – is the key policy goal but this can only be achieved in the longer term with continued efficient use of, and investment in, infrastructure.

Declaration of services

4.12 In general terms, Part XIC obliges providers of 'declared services' to provide access to those services. The ACCC may declare certain eligible carriage services and related services (such as billing data, billing services and conditional access equipment) to be 'declared services'. To date the ACCC has declared basic PSTN, mobile, cable, digital data, trunk and ISDN services, and local loop services.

4.13 Any carrier or carriage services provider that provides declared services (access provider) is required to comply with 'standard access obligations' in relation to the provision of those services to those seeking access (access seekers).

Standard access obligations

4.14 In very general terms, the standard access obligations[6] (SAOs) require the access provider to give access of an equivalent technical and operational quality to others as it provides to itself, and to make available additional services like fault detection, handling and rectification of technical and operational problems of the declared service.

Conditions of access

4.15 The terms on which the access provider must satisfy the standard access obligations in dealings with an access seeker—including price and non-price terms—are subject to commercial agreement between the parties.

4.16 If the access seeker and access provider cannot reach agreement, the following consequences apply. An access provider may give an 'access undertaking' to the ACCC setting out the terms and conditions on which access will be given to active declared services.[7] The terms and conditions of access will be those set out in the undertaking.

4.17 If the undertaking does not specify terms and conditions about a particular matter, the terms and conditions relating to that particular matter will be as determined

5 Paragraph 152AB(e).

6 Section 152AR.

7 To be operative, the undertaking must be accepted by the ACCC.

by the ACCC in an arbitration. If there is no access undertaking, the terms and conditions will be as determined by the ACCC in an arbitration.[8]

4.18 Any determination by the ACCC must not be inconsistent with the SAOs or any access undertaking.

Model terms – core services

4.19 Following amendments to the TPA in 2002, the ACCC must determine and publish model terms and conditions of access for specified declared services.[9] The 'core' services are:

(a) the domestic public switched telephone network (PSTN) originating and terminating access services;

(b) the domestic public switched telephone network terminating access service;

(c) the unconditioned local loop service (ULLS);

(d) the local carriage service (LCS); and,

(e) any additional core service specified in regulations by the minister.[10]

4.20 The ACCC may take into account any model terms and conditions when conducting arbitrations.

Price of access

4.21 The price of access is commonly the key commercial term in access negotiations. Failure to agree on price means that negotiations fail and no access is provided. As this would not be in the interests of end users, the TPA provides for the ACCC to resolve the issue of price if there is no agreement.

4.22 Furthermore, the ACCC is required to determine and publish principles relating to the price of access to declared services.[11] The ACCC must have regard to these principles in any arbitration about terms of access to a declared service.

Ordinary and anticipatory exemptions from SAOs

4.23 Part XIC had always allowed carriers—both individually or as a class—to seek exemption from any or all of the standard access obligations in section 152AR.[12]

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8 Section 152AY.

9 The ‘core services’ are the domestic PSTN originating and terminating access services; the unconditioned local loop service (ULLS); the local carriage service (LCS); and any additional core service specified in regulations by the Minister.

10 Section 152AQB.

11 Section 152AQA.

12 Sections 152AS, 152AT.

4.24 In 2002, in response to the report of the Productivity Commission on telecommunications,[13] the TPA was amended to include mechanisms that would give investors in infrastructure certainty about the conditions that would apply to their investments.[14]

4.25 The ACCC is now able to exempt carriers and carriage service providers—either individually or as a class—from any or all of the standard access obligations in relation to services which have not been declared and may not be built.[15] In order to encourage the prompt assessment of applications, the ACCC is taken to have made an exemption order if it does not make a decision within 6 months.[16] The decision-making period may be extended by up to three months if the ACCC provides reasons for the delay.[17]

Special access undertakings

4.26 The other mechanism that was inserted by the 2002 amendments to provide certainty for investors in facilities was the creation of special access undertakings.[18]

4.27 This mechanism enables a business that is contemplating an investment in infrastructure to lodge 'access undertakings' with the ACCC. Such undertakings set out the terms and conditions on which the facilities owner is willing to permit access to the infrastructure or services when they are built.

Key issues

4.28 The operation of the access regime has been criticised by both access seekers and access providers. In general terms, access providers argue that the scheme operates as a disincentive to investment in infrastructure. This is, they say, because of the uncertainty about whether, and on what terms, new infrastructure may be declared by the ACCC and on what terms access may be provided, factors which would impact upon calculations of return on investment.

4.29 On the other side, the concerns of access seekers arise out of the difficulty of competing against vertically integrated service providers—particularly Telstra, which owns and operates the local loop, the key bottleneck facility. Access seekers argue that the access regime fails to curb the incentive and ability of vertically integrated operators to favour themselves by such means as:

- actions designed to resist or delay declaration;

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13 Productivity Commission, *Telecommunications Competition Regulation*, Report No. 16, 2001.

14 The *Telecommunications Competition Act 2002* amended the *Trade Practices Act 1974*.

15 Section 152ATA.

16 Subsection 152ATA(10).

17 Subsection 152ATA(14).

18 Part XIC, Division 5, Subdivision B.

- regulatory gaming in relation to the undertakings and exemptions mechanisms;
- deferring agreement as to terms of access;
- favouring themselves in relation to price and the extent, nature and quality of services that are made available to wholesale customers;
- by negotiating access on uncommercial terms; or
- by physically restricting or delaying access to facilities needed for access or interconnection.

4.30 The CCC told the Committee, for instance, that:

> The ACCC, the Productivity Commission, the National Competition Council and many others have consistently identified Telstra's structure and the incentive for it to favour itself over competitors when providing access to bottleneck facilities as the core problem.[19]

4.31 These observations accord with the general observations of the OECD in 2001:

> An integrated firm, in contrast to a separated firm, benefits from any action which delays the provision of, raises the price or lowers the quality of access. An integrated firm will therefore use whatever regulatory, legal, political or economic mechanism [is] in its power to delay, restrict the quality or raise the price of access. Furthermore, the integrated firm has strong incentives to innovate in this area, constantly developing new techniques for delaying access. Although the regulator can address these techniques as they arise, it is likely to always be "catching up" with the incumbent firm. Regulation, despite its best efforts, is unlikely to be able to completely offset the advantage of the incumbent.[20]

4.32 In addition to the difficulties outlined above, access seekers argue that access prices do not provide an incentive for investment in infrastructure. They argue that because prices are too high they are not able to build a profitable business which would justify—and pay for—investment in infrastructure.

4.33 Specific concerns are addressed in turn below:

- the process of declaring services;
- inherent delays in the regime;
- regulatory gaming;
- impediments other than access price;
- facility sharing; and

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19 CCC, *Submission* 14, p. 5.

20 OECD, *Restructuring Public Utilities for Competition*, OECD, Paris, 2001, p. 17.

- pricing issues.

The process of declaring services

4.34 There is no general right of access to telecommunications until a service is declared. As noted above, the declaration of a service must promote the long term interests of end users and the ACCC must have regard to certain objectives:

- promoting competition in markets for listed services;
- achieving any-to-any connectivity in relation to carriage services; and
- encouraging the economically effective use of, and the economically efficient investment in, the infrastructure by which listed services are supplied.[21]

4.35 The ACCC must also conduct a public inquiry into a proposal to declare a service.

4.36 Many services have been declared: domestic PSTN originating and terminating access, domestic GSM originating and terminating access, domestic transmission capacity service, Digital Data Access Service, conditioned local loop service, unconditioned local loop service, ISDN originating and terminating service, Local Carriage Service, Local PSTN Originating and Terminating Service, Analogue Subscription Television Broadcast Carriage Service, line sharing service and the mobile terminating access service.

4.37 However, the process can be slow and not all services that are arguably critical have satisfied the criteria for declaration. The Communications Experts Group, for instance, submitted:

> There are some services which are critical for competition or delivery of Telecommunications services that are not declared, and the ACCC have stated clearly that under the current regime they cannot be declared.
>
> In many cases it is impossible to get access to data that will be acceptable to a court of law, and that can be used to construct a sound economic or legal argument to declare a service.[22]

4.38 Where services are not declared, there is no requirement to provide access or to ensure equivalent quality of access. In some circumstances, there is little commercial incentive for services to be made available to competitors. Mr Christopher Hill from the Western Australian Local Government Association (WALGA) gave the following explanation for Telstra's apparent reluctance to offer ADSL services in markets where it already had an ISDN customer base:

> There is a subtle difference between having a vested interest and slowing something down versus just lacking interest in promoting something or

21 Subsection 152AB(2).

22 Communications Experts Group, *Submission* 26, p. 5.

> ensuring something happens. Things get prioritised down the list. I was describing the risk of cannibalisation of existing lucrative cash flows when moving ISDN customers over to ADSL services. Take it to an extreme. Why would a fully commercial operation want to open up a world-class network for their competitors to use?[23]

4.39 The Committee heard criticism that certain other wholesale services were not available. It is not clear from the evidence whether it was agreed that these services should be declared, but there was a general view that the services should be made available. Telstra's business grade DSL service was mentioned in evidence by two witnesses as a service that had neither been declared nor made widely available by Telstra to other customers. The CCC observed that:

> … often, the infrastructure that is available to Telstra retail is different, and superior to that available to Telstra's wholesale customers. An example is business grade DSL which is available to customers of Telstra Wholesale in far fewer locations (enabled exchanges) as it is to Telstra retail customers.[24]

4.40 Similarly, Mr Paul Fletcher from Optus told the Committee that access to Business Grade DSL was difficult to obtain:

> We have been seeking to get that service to be able to resell to our own customers for many months—probably 12 months. Telstra's initial position was, no, you cannot have it, and the reason given was that the retail business did not want us to have it. Telstra's more recent position is that they are studying the matter, and they are looking to see whether they can provide a wholesale service, but one might expect that it is going to be studied quite thoroughly.[25]

Inherent delays in the regime

4.41 The processes involved in the access regime are inherently time consuming. In 2001, the Productivity Commission observed that the decisions about declaration alone took from 2 to 22 months[26] and the process of assessing Telstra's undertakings had taken about 18 months on average.[27] The assessment of requests for exemptions from the standard access obligations can also take considerable time. Further delays are likely where the ACCC is asked to arbitrate a notified dispute.

4.42 Most declarations were made some time ago in relation to services which use the local loop, and the rate at which declarations have been made has declined

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23 Mr Christopher Hill, *Committee Hansard*, 29 April 2005, p. 14.

24 CCC, *Submission* 14*,* Attachment 1, p. 11.

25 Mr Paul Fletcher, *Committee Hansard*, 4 May 2005, p. 102.

26 Productivity Commission, *Telecommunications Competition Regulation*, Report No. 16, 2001, p. 229.

27 Productivity Commission, *Telecommunications Competition Regulation,* Report No. 16, 2001, p. 234.

markedly since. There is now less scope for further declarations to be made in relation to such services. Nonetheless, further declarations remain a possibility, particularly in relation to new services operated over so-called next generation networks. Delays at the declaration stage will therefore remain an issue. Similarly, the Committee considers that the assessment of undertakings will remain a continuing source of delay, notwithstanding Telstra's avowed reluctance to use this device following the rejection of its first four undertakings. It is more likely, however, that future delays will occur later in the access process, such as in the ACCC's consideration of exemption applications or arbitration of disputes.

4.43 Telstra argued that the ACCC's process of assessing undertakings is still too protracted despite the 2002 amendments to the TPA which allow for anticipatory exemptions. Telstra observed:

> While it might have been possible to attribute delays with the ACCC's assessment of Telstra's original PSTN undertaking to the ACCC's unfamiliarity with the access regime, such regulatory delays have continued in relation to other undertakings lodged by Telstra.[28]

4.44 For instance, in November 2003, Telstra lodged a revised undertaking for domestic PSTN originating and terminating access services, the Unconditioned Local Loop Service and the Local Carriage Service, but:

> … it was not until nearly one year later (October 2004) that the ACCC released its draft decision proposing rejection of Telstra's undertaking with respect to the Unconditioned Local Loop Service and gave some qualified acceptance of Telstra's undertakings in relation to the domestic PSTN originating and terminating access services and the Local Carriage Service.[29]

4.45 A decision on Telstra's Unconditioned Local Loop Service undertaking had not been made at the end of June 2005.[30]

4.46 While these timeframes seem unacceptable and not conducive to bringing about commercial certainty in a timely way, the Committee considers that the accumulation of knowledge and expertise by the ACCC—in relation to pricing, for instance—with each successive assessment is likely to create efficiencies. In any case, the Committee is not convinced that these delays are entirely the fault of the ACCC, as discussed in the next section.

Regulatory gaming and delay

4.47 In addition to the inherent time lags, the access regime presents opportunities to resist and delay access through regulatory gaming. These opportunities exist at all

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28 Telstra, *Submission* 25, p. 27.

29 Telstra, *Submission* 25, p. 27.

30 Telstra, *Submission* 25, p. 27.

steps of the access process: declaration, the granting of exemptions, the giving of undertakings, the development of model terms and conditions by the ACCC, negotiation over access terms and in dispute and arbitration processes. Furthermore, decisions at many of these points are appellable either on their merits or on questions of law. It is not surprising that many of these opportunities are taken and that the Productivity Commission identified delay as an issue.[31]

4.48 The Productivity Commission's report gave a good example of the potential for delay. Notwithstanding that access providers may have given access undertakings to the ACCC, they will commonly continue to seek commercial resolution of access requests. If those negotiations are unresolved and lead to a notified dispute requiring arbitration, the ACCC will be faced with the concurrent consideration of both the undertaking and the dispute. The ability of access providers to lodge amended undertakings adds another layer of complexity to the situation. The Productivity Commission's report outlined a dispute between AAPT and Telstra:

- in November 1997, Telstra lodged a PSTN undertaking with the ACCC;
- in December 1998, AAPT notified the ACCC of a PSTN dispute with Telstra;
- in June 1999, the ACCC rejected Telstra's PSTN undertaking and in doing so estimated 'efficient' access prices;
- in September 1999, the ACCC made an interim determination for the AAPT– Telstra dispute;
- in September 1999, Telstra lodged a revised PSTN undertaking with the ACCC;
- in April 2000, ACCC released a draft assessment of the revised undertaking, updating its estimate of 'efficient' access prices;
- in June 2000, the ACCC revised the interim determination between AAPT and Telstra;
- in July 2000, the ACCC rejected Telstra's revised undertaking, further refining its estimate of access price; and
- in September 2000, the ACCC made a final determination for the AAPT– Telstra PSTN dispute.[32]

4.49 The Committee did not receive detailed evidence about more recent episodes of this kind, but notes that changes were made to the TPA in 2001[33] and 2002[34] to

31 Productivity Commission, *Telecommunications Competition Regulation*, Report No. 16, 2001, p. 217.

32 Productivity Commission, *Telecommunications Competition Regulation*, Report No. 16, 2001, p. 235.

33 *Trade Practices Amendment (Telecommunications) Act 2001.*

34 *Telecommunications Competition Act 2002.*

expedite the process of resolving access issues. These include powers to determine pricing principles,[35] and non-binding model terms for 'core services'.[36]

4.50 Nonetheless, the Committee heard criticism of continued sluggishness in the access regime. A typical comment was that of the CEPU:

> The declaration process has resulted in protracted inquiries and even more protracted considerations of carrier undertakings. It must be admitted that, as a result, it has not produced timely outcomes or provided access seekers and access providers the degree of certainty that they reasonably require. It has also presented all parties with ample opportunities for regulatory gaming. These circumstances have provided the ACCC with the incentive to find short-cuts in the determination of access pricing issues. Part XIB and now the retail price controls have provided the means.[37]

4.51 Similarly, Mr Paul Budde observed:

> True, the worry remains that the incumbent – be it BT, Telstra or whoever – will continue to play regulatory games; undermining the process through their armies of lawyers, lobbyists and spin-doctors.[38]

4.52 Mr Graeme Samuel, Chairman of the ACCC, noted that:

> … on a broader level, there are disturbing signs that the undertaking process has become increasingly subject to regulatory game playing. In some cases, there have been lengthy delays between the lodgement of an undertaking and the provision of the supporting documentation. In others, undertakings have been lodged that are simply inconsistent with the underlying costing information. This type of behaviour does not appear to indicate a genuine commitment to the undertaking process, which is intended to achieve more timely industry outcomes.
>
> It is important to note that the consideration of an undertaking need not stop the Commission in the meantime from conducting an arbitration, if required, and issuing an interim determination. In this regard, the undertakings currently before the Commission won't necessarily delay the consideration of current or potential access dispute notifications regarding the services in question.[39]

4.53 Specific examples of regulatory gaming were identified by the CCC, which pointed to the scheme relating to undertakings as a substantial source of difficulty. The submission of undertakings can be used as a tactic to delay the resolution of a

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35 Section 152AQA.

36 Section 152AQB.

37 CEPU, *Submission* 40, p. 19.

38 Mr Paul Budde, *Submission* 1, p. 10.

39 Mr Graeme Samuel, speech to Australian Telecommunications Users Group, 10 March 2005, http://www.accc.gov.au/content/item.phtml?itemId=591603&nodeId=file422f9e9581125&fn=20050310%20ATUG.pdf.

pricing issue and the submission of amended undertakings that varied only slightly but which tied up the resources of the ACCC and industry by requiring individual assessment.[40] The CCC referred to the ability of access providers to 'systematically frustrate competition by denying equitable access through a wide variety of mechanisms, including inaction and regulatory "gaming" activities'.[41] The CCC also stated:

> The CCC has contended previously that the undertakings process in telecommunications has been systematically gamed by Telstra as a means of delaying the resolution of pricing concerns in relation to core services. For example, through 2004 and 2005, the ACCC and industry was forced to respond to three different sets of undertakings in relation to Unconditioned Local Loop (ULLS) and Line Sharing (LSS) services. Telstra withdrew the first two sets of submissions just before the ACCC published a final determination, and replaced them with new undertakings, requiring the whole process to start again from scratch. Similar abuses of the process occurred in relation to PSTN interconnect.[42]

4.54 Mr Stephen Dalby from iiNet gave another example:

> We believe [Telstra] quite deliberately use delaying tactics to minimise the impact of competition. I can give some examples. When negotiating with us—and this sort of stems back to having this clash with the supplier who is supplying your services at an almost retail level, to then asking them to supply our services on a more honestly wholesale level—it is very much a take-it-or-leave-it approach. 'Yes, you can have that product. There are the terms and conditions.' They will supply it to you as a draft for discussion, but there is no discussion.[43]

4.55 Others made similar observations. ATUG, for instance, stated:

> … the ACCC reports unwelcome gaming of the undertakings process (both in the fixed and mobile parts of the market) and the increased number of access disputes on the mobile termination issue suggest to ATUG that the philosophy of light touch regulation may not be adequate to the realities of this industry.[44]

4.56 The same point has been made in other countries with integrated incumbents, such as the UK.[45]

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40 CCC, *Submission* 14, Attachment 1, p. 15.

41 CCC, *Submission* 14, p. 5.

42 CCC, *Submission* 14, paper 3, pp 6-7.

43 Mr Stephen Dalby, *Committee Hansard*, 29 April 2005, p. 40.

44 ATUG, *Submission* 20, p. 12.

45 OFCOM, *Strategic Review of Telecommunications Phase Two Consultation Document*, November 18 2004.

Impediments other than access price

4.57 Access price is only one way in which access may be impeded or effectively denied. The Committee heard of other behaviours from which it could be inferred that access is being impeded. There were many reports of competitors attempting to roll out alternative facilities, only to have Telstra engage in strategies which appear designed to sabotage those efforts. This has had a detrimental effect on investment. The Chairman of the ACCC explained the position in a recent speech:

> Since the ULLS was declared in 1999, rival telcos have predominantly used the service to compete with Telstra in the business markets in inner city areas. To compete for customers in the residential market, on the other hand, access seekers have largely relied on Telstra's wholesale ADSL service.
>
> Broadband take up has now reached the point, however, where it is becoming increasingly viable for access seekers to roll-out their own DSL infrastructure into a larger number of Telstra's exchanges.
>
> Increased infrastructure roll-out would allow competitors to provide a much higher quality, and more diverse range of broadband and other services than is possible by simply reselling the Telstra wholesale ADSL service. There is clear potential, for example, for full video services to be provided over DSL technologies. It is imperative, therefore, that Telstra's competitors have timely and efficient access to exchanges in order to enable them to roll-out services to the mass market.
>
> A number of commentators have pointed out the potential for an incumbent to engage in non-price discrimination or 'sabotage' to kill off this competition before it even gets a foothold by, for example, raising the costs of accessing essential inputs. The potential for sabotage is especially pertinent in light of recent concerns raised by competitors contemplating the mass roll-out of ULLS/LSS based services.
>
> Some of these complaints raised directly with the Commission include the prospect of significant delays and associated costs in gaining access to Telstra exchanges. The Commission notes that the current ULLS provisioning processes are ill-suited to addressing these concerns within the context of a rapid mass-market DSLAM deployment.
>
> To date, Telstra has been slow to improve processes to enable large-scale roll-outs and has not demonstrated a real commitment to changing its systems to meet these needs.[46]

4.58 Mr Samuel noted that the ACCC's views 'appeared to be supported by comments attributed to the Telstra CEO at the time of Telstra's half-yearly results':

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46 Mr Graeme Samuel, speech to Australian Telecommunications Users Group, 10 March 2005, at http://www.accc.gov.au/content/item.phtml?itemId=591603&nodeId=file422f9e9581125&fn=20050310%20ATUG.pdf.

> According to the AFR of 14 February 2005, the CEO noted that Telstra had developed 'mitigating strategies' to address the increasing prospect that competitors will seek to roll-out their own DSL networks. This reference to 'mitigating strategies' could potentially be interpreted in a sinister fashion.
>
> However Dr Switkowski has assured me that what Telstra had in mind was the launch of more attractive products for its wholesale customers. It remains to be seen which interpretation is ultimately proven to be the correct one.
>
> I can assure you the Commission will not look lightly on any attempts by Telstra to impede or hinder competition, for example by slowing the roll-out of DSLAMs, and is prepared to deal accordingly with any such behaviour.[47]

4.59 While this sentiment from the ACCC may be welcome, in light of its inability to respond to widespread frustrating tactics in the past (as discussed earlier) there are real doubts as to whether the ACCC is able to deal with such behaviour.

4.60 As discussed in the previous chapter, a number of witnesses gave evidence of the commercial impediment created by Telstra's DSL churn price. Mr Shaw from PowerTel, for example, explained that migrating customers from Telstra's network could be prohibitive.[48]

4.61 Mr Ian Slattery from Primus made similar observations:

> As a 'back of the envelope', when we look at the mass migration that Primus is intending to undertake to move its customers off a Telstra resale service onto our own DSLAM network, the total cost that we will be up for, given this $90 connection charge, will come in at around the same amount as our total capital costs and infrastructure.[49]

4.62 Telstra explained its pricing structure in an answer to questions on notice:

> Where the migration of multiple services is involved, the physical exchange work that needs to be done to complete each transfer is the same as the work for one service, i.e the disconnection of the existing copper path from its own equipment, followed by reconnection of it to the Telstra Wholesale customer's equipment, followed by the jumpering of an additional cable back to the Telstra equipment to ensure the underlying voice PSTN service operates – making the work required to transfer a number of services a simple multiple of that done for one. Where efficiencies from performing multiple orders in a particular exchange are realised (such as reduced travelling times for field staff), these cost savings are passed on to the Access Seeker.

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47 Mr Graeme Samuel, speech to Australian Telecommunications Users Group, 10 March 2005.

48 Mr Errol Shaw, *Committee Hansard*, 11 April 2005, p. 23.

49 Mr Ian Slattery, *Committee Hansard*, 11 April 2005, p. 23.

> Although the jumpering work is manual, and cannot be automated, Telstra Wholesale does enter into commercial arrangements based on volumes, where it passes on the benefits of the efficiencies gained. Actual pricing for the service, when part of a commercial deal, is bound by customer confidentiality arrangements.[50]

4.63 In addition to disincentives created by high churn costs for DSL, the Committee heard evidence about other actions or strategies which delay access to exchanges. The Productivity Commission's 2001 report alluded to submissions it had received about Telstra's actions, which had the effect of delaying physical access, including 'losing the keys to the exchange'.[51] Mr Paul Budde's submission to this inquiry also referred to this phenomenon.[52]

4.64 As outlined in Chapter 3, TransACT gave evidence of more recent experiences of a similar kind. At a greenfield development in Gungahlin where it was attempting to get customers for its DSL service in competition with Telstra, TransACT encountered several hurdles that delayed its capacity to sign up customers.[53] In a fast moving market, access delays can have a significant anti-competitive effect.

Facility sharing

4.65 The complaint that Telstra impedes or delays access to exchanges points to a related issue which some submissions addressed, namely, access to facilities. Although not an access issue under Part XIC, access to the facilities of other carriers can nonetheless operate as an impediment to the operation of the access regime and to competition more generally. Part 5 of Schedule 1 to the Telecommunications Act gives carriers rights of access to certain facilities (not including exchanges) of other carriers.

4.66 The Committee heard that there is a case for the introduction of regulations to facilitate the sharing of Common User Telecommunication Infrastructure to reduce costs and increase competition.

> The current regulatory [regime] has no provision for the sharing of infrastructure and the current ACA guidelines for sharing radio masts are easily nullified by legal and contractual debates.

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50 Telstra, *Submission* 25A, p. 1.

51 Productivity Commission, *Telecommunications Competition Regulation*, Report No. 16, 2001, p. 22.

52 Mr Paul Budde, *Submission* 1, p. 1.

53 Mrs Dianne O'Hara, *Committee Hansard*, 20 June 2005, pp 3-4.

> In many cases the "first provider or user" can block and delay other carriers from access to the infrastructure, even though totally different (or non-competing) services are being introduced.[54]

4.67 The Communications Experts Group called for the introduction of Common User Telecommunication Infrastructure and for amendments to the legislation to prevent infrastructure being built which is capable of use by a single user or for a single purpose. It also calls for a strengthening of the facilities access legislation.[55]

4.68 In Dubbo, the Committee heard of the poor level of service people in rural areas receive. The need to share facilities to reduce cost was raised as a possible solution by Mr Tom Warren:

> There are quite a large number of other issues. I suppose one solution would be to share towers. Too often we see several towers in the same vicinity: one for Optus, one for Telstra and one for someone else, yet we still do not seem to be able to get services.[56]

4.69 The facility sharing model was also proposed by Mr Peter Lindsay MP in Townsville where a similar arrangement exists for the sharing of television antenna:

> There would be a multiuser base station in areas where it is not economic for all carriers to provide 3G base stations. The technology is there to do it—the one transmitter, the one antenna and the one building can link into the various networks—but there would have to be some legal framework and some agreement between the carriers to allow that to happen. There is a possibility that whichever entity does this could negotiate with the local shire council, who might provide the water tower or whatever to get the services into their town. This model is not too different from that of Broadcast Services Australia, who maintain many of the television transmitters around. They maintain the WIN television network, the SBS network and the ABC network all from the one site. The one operating company maintains it for a multiplicity of users.[57]

4.70 The Committee notes the recent 3G network facility sharing agreement between Hutchison and Telstra and sees this as an encouraging development in the sector. The Committee sees merit in consideration being given to a strengthening of facilities access regulation and its extension to other facilities to which access has become more critical, such as local exchanges.

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54 Communications Experts Group, *Submission* 26, p. 5.

55 Communications Experts Group, *Submission* 26, p. 5.

56 Mr Tom Warren, Orana Development and Employment Council, *Committee Hansard*, 14 April 2005, p. 50.

57 Mr Peter Lindsay MP, *Committee Hansard*, 21 April 2005, p. 5.

Pricing issues

4.71 A key term in access arrangements is price, since without agreement on price, there will be no access. The assessment and determination of price is one of the most vexed issues in the regime.

4.72 The two key concerns appear to be that price takes too long to be established—due to the timeframe inherent in the system and the consequent gaming of the scheme (discussed earlier)—and that prices are too high (according to access seekers) or too low (according to access providers).

4.73 As noted above, the CCC identified the gaming of the undertakings process as a key flaw in the scheme and argued that the process has not achieved the 'clarity and certainty in pricing on an industry wide basis' that was intended:

> The introduction in 2002 of the process requiring the ACCC to determine indicative price terms and conditions for core services both demonstrates the failure of undertakings to prevent access disputes and makes the undertakings regime even more of an uncomfortable fit with the rest of the regime.
>
> Further evidence that undertakings are incompatible with the effective management of competition in communications has been their use (the CCC would argue, clear abuse) by Vodafone and Optus in an attempt to prevent the ACCC's efforts to regulate the prices for fixed to mobile termination services to a cost reflective basis.
>
> Clearly, if the mechanism is being used to prolong the process of providing pricing certainty, it is achieving the opposite of what was intended.[58]

Price and the efficient use of, and investment in, facilities

4.74 As noted above, in administering Part XIC the ACCC must have regard to the extent to which the economically efficient use of, and the economically efficient investment in, the infrastructure by which listed services are supplied is encouraged.[59]

4.75 The Productivity Commission concluded that this consideration should be elevated to the object of Part XIC, in place of the promotion of the long term interests of end users.[60] The Government has agreed to insert a variation of this formula in the object of Part IIIA of the TPA, which is the general access scheme for other industries.[61]

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58 CCC, *Submission* 14, attachment 1, p. 15.

59 Subsection 152AB(2).

60 Productivity Commission, *Telecommunication Competition Regulation*, Inquiry Report, Recommendation 9.1, p. xxxviii. The Commission suggested the object be changed to the promotion of 'the economically efficient use of, and investment in, telecommunications services'.

61 Trade Practices Amendment (National Access Regime) Bill 2005, proposed section 44A.

4.76 As noted earlier, the efficient use of, and investment in, infrastructure is encouraged by an access regime which aims to encourage sound decisions about whether to build new facilities or buy access to existing facilities and services.

4.77 The original policy goal of the Part XIC access regime was, in the short term, to enable access to publicly owned infrastructure—predominantly, the fixed local loop—in order to encourage competition in new and innovative services. If this enabled those access seekers to build a sufficiently profitable customer base, they may have both the incentive and capacity to invest in their own facilities, which would reduce their dependence on upstream providers. The Committee heard that this was indeed the intention of competitors. Mr Errol Shaw from PowerTel for instance, endorsed this view:

> You would normally set your business up by wholesaling Telstra's DSL product, getting a customer base, then putting your infrastructure in place so you can make money out of it.[62]

4.78 Mr Stephen Dalby from iiNet said:

> We have taken the approach that once we have sufficient scale we will then examine building our own infrastructure. We use somebody else's infrastructure, we buy their gear, we buy their wholesale products and resell them and, when we reach a point where the business case is good enough, we then build our own infrastructure.[63]

4.79 It is clear that an important factor in the profitability of access seekers is price. Low prices clearly favour access seekers, but they may damage investment in infrastructure. Telstra explained:

> An artificially low access price has two damaging effects on investment.
>
> A low access price discourages efficient investment by infrastructure owners as they will not be able to attract sufficient investment funds to finance a network roll-out relative to competing investment opportunities. They may also decide that the risk-adjusted return exceeds any benefits, or that their money is better allocated to other, more profitable, investment opportunities.
>
> A low access price discourages efficient investment by market entrants - as they will have the ability to free-ride on the infrastructure of existing infrastructure owners, therefore reducing the costs of market entry.[64]

4.80 Low prices may also assist inefficient access seekers to remain in business.

4.81 On the other hand, high access prices may discourage or prevent the entry of alternative service providers into downstream markets or, at least, make it difficult for

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62 Mr Errol Shaw, *Committee Hansard*, 11 April 2005, p. 23.

63 Mr Stephen Dalby, *Committee Hansard,* 29 April 2005, p. 39.

64 Telstra, *Submission* 25, p. 56.

them to build businesses profitable enough to justify investment in alternative infrastructure.

4.82 That access prices are too high is clearly a view held by service providers acting in their capacity as access seekers. The Committee notes, however, that a carrier or provider may simultaneously be both an access seeker (in relation to, say, fixed line services) and an access provider (in relation to mobile terminating access) and may therefore hold the view that prices are too high and too low. While different considerations prevail, this does illustrate the intractability of the problem.

4.83 Telstra argues that there is a low-price bias in the access regime and its administration:

> … in practice, in setting access prices, the ACCC has regularly failed to recognise the efficiently incurred costs of providing access to declared services. As a result, infrastructure owners are unable to be assured of secure sustainable returns on their investment.[65]

4.84 Furthermore, Telstra argued that low access prices deter investment by access seekers:[66]

> If the access regime is designed to maximise the long-term interests of end users, then competitors must be provided with a price signal that will encourage efficient investment by both entrants and the incumbent.[67]

4.85 One reason that this is so, according to Telstra, is that 'the ACCC has been preoccupied with promoting short-term competition without properly focussing on the need to promote long-term investment'.[68]

4.86 This accords with the view of the CEPU, which observed that the present position reflects 'a policy and regulatory bias that since 1992 has kept access, and more recently resale, prices low to encourage competitive entry'.[69]

4.87 However, this view is not universally shared. Mr Chris Hill on behalf of the Western Australian Local Government Association (WALGA) observed:

> The Australian public has invested over the last several decades in building an infrastructure that is, in fact, world class at the core. There is a world-class backbone, world-class infrastructure at the exchanges, world-class access methods, but unfortunately the pricing regimes are such that no-one can afford to access them.[70]

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65 Telstra, *Submission 25*, p. 3.

66 Telstra, *Submission* 25, p. 25.

67 Telstra, *Submission* 25, p. 56.

68 Telstra, *Submission* 25, p. 25.

69 CEPU, *Submission* 40, p. 15.

70 Mr Christopher Hill, *Committee Hansard*, 29 April 2005, p. 5.

4.88 Optus views access pricing as an impediment to facilities-based competition, arguing:

> Broadband is the key area where policy and regulatory focus is needed. Development of the broadband market has reached a crucial point and Telstra has recently shown its intent to stymie competition in this market. With the right regulatory settings, competitive players like Optus are on the verge of building competitive access networks. But a key impediment is resale interconnect pricing, which acts as a dampener to competitors building their customer base which in turn hampers the speed and scale of possible network builds.[71]

4.89 Optus outlined its 'Bridge to Broadband' proposal in response.[72] Optus stated that it was 'poised for major roll out of competition infrastructure', but that the speed and scale of the proposed roll out depended on its capacity to grow its resale customer base. This is currently hampered by the poor returns in providing customer resale services. Optus proposed that a more attractive local call resale service (LCR) should be offered to competitors who commit to significant DSL build:

> The essence of the "bridge to broadband" proposal is that competitive carriers and service providers are given a more favourable LCR interconnect rate in return for making commitments in relation to a large scale DSL build. This would be for a build that is of a greater scale and is rolled out more quickly than would be feasible for Optus under current scenarios.[73]

The cost of backhaul

4.90 One aspect of access pricing which attracted much comment during this inquiry was transmission pricing (sometimes called backhaul), particularly in regional areas. *The Australian* newspaper reported on 7 June 2005 that the ACCC had 'received complaints over the past month from a number of internet service providers over backhaul pricing in non-metropolitan areas':

> There is evidence that high backhaul pricing is reducing broadband competition in non-metropolitan areas. Perth ISP iiNet complained to the ACCC about regional backhaul. iiNet chief executive Michael Malone said 30 per cent of the ISP's customers were in non-metropolitan areas, but the cost of backhaul pricing was too high for it to consider installing high-speed equipment in some towns.

71 Optus, *Submission* 12, p. 3.

72 Optus, *Submission* 12, p. 7.

73 Optus, *Submission* 12, p. 7. Specifically, Optus proposed that Government fix the LCR wholesale price at 10 cents per call and the monthly line rental at $25 for a limited period of time. Optus, in return, would enter into a network development deal.

> "In the metropolitan areas we have alternative suppliers we can talk [to], but elsewhere you've only got Telstra," Mr Malone said.[74]

4.91 These and other comments prompted the Committee to seek the views of witnesses. Mr Stephen Dalby from iiNet stated:

> As has been mentioned a number of times this morning by other witnesses, the ongoing costs, the recurring costs of backhaul, kill the business plan for us to put a DSLAM or a broadband facility into a country town. We could run a service for two years on the subsidies and after that we would run in the red and we would leave town.[75]

4.92 Dr Walter Green from the Communications Experts Group described the cost of backhaul as 'the killer' which has 'a huge impact on quite a number of areas' particularly in northern Western Australia.[76]

4.93 The Western Australian Department of Industry and Resources (WADIR) also observed that the manner in which backhaul tariffs were calculated led to high backhaul prices in regional areas:

> A major structural issue inhibiting the effectiveness of the third party access regime to the telecommunications network is the widespread practice of imposing distance-based tariffs on regional backhaul (long-distance cable) routes. The Government of Western Australia believes that removing distance-based tariffs associated with backhaul (long-distance cable) routes would create a substantial shift in commercial incentives. Indeed, the impact is likely to force wholesale backhaul providers to consider applying volume-based tariffs. In turn, a volume-based tariff regime would require a substantial increase in transit traffic created by the accelerated introduction of new innovative services, thereby creating considerable benefit and opportunity for regional communities.
>
> Maximising the speed of new service deployment in regional Australia calls for change through regulation to:
>
> - eliminate distance-based tariffs; and
> - create a National Internet Protocol Network.[77]

4.94 Expanding on these comments, WADIR stated:

> The difficulty with the current distance-based tariff structure is that backhaul routes carrying relatively little traffic become punitively expensive. The viability of providing downstream services to regional communities is undermined, as all service charges have to recover costs

74 http://australianit.news.com.au/articles/0,7204, 15532088%5E15318%5E%5Enbv%E15306,00.html.

75 Mr Stephen Dalby, *Committee Hansard*, 29 April 2005, p. 41.

76 Dr Walter Green, *Committee Hansard*, 29 April 2005, p. 19.

77 WADIR, *Submission* 32, p. 5.

> imposed by distance-based tariffs. The result is severely reduced transit traffic with end-users in effect paying for substantial idle capacity.
>
> The effectiveness of the market in dealing with this has been limited. Along certain backhaul routes competition through infrastructure duplication (facilities-based competition) has been effective at reducing distance-based tariffs, e.g. the main routes between Australia's capital cities. In other cases, where backhaul routes serve smaller population centres, facilities-based competition is unlikely to be effective because the value of traffic transiting regional backhaul routes is often insufficient to support infrastructure duplication. In these cases, some form of regulatory intervention may be warranted.[78]

4.95 Dr Walter Green referred to calculations of the profitability of certain backhaul links and concluded that there is a 'substantial scope within the backhaul prices to reduce the prices' and that 'controlling the backhaul price is the biggest inhibitor to providing services in the rural areas'.[79]

4.96 Regional Internet Australia (RIA) observed that competition had been effective in driving down transmission prices in many metropolitan areas and on some inter-city routes, but argued that Part XIC had not led to facilities competition in many regional areas or resulted in reasonable access conditions:

> Part XIC … has operated effectively to encourage new entrants in the major metropolitan areas. The ACCC has found that certain services no longer need to be declared in or between state capital cities as competition has been introduced effectively.
>
> However, RIA is concerned that the access regime provided in Part XIC has not been proved effective in the supply of services which are essential to the roll out of regional broadband services. Specifically, the transmission service declared under Part XIC provides access to Telstra's fibre and is expressed to be priced based on the long run incremental cost. That is, the selling price should reflect the cost incurred by an efficient operator in supplying the service (and allowing for a return at the weighted average cost of capital).
>
> RIA has found that it is cheaper to construct microwave radio based links than to acquire access to optical fibre from Telstra. This is an indication that the access regime is not working and that there is duplication of capital intensive infrastructure deployment in regional areas which can least afford it. This issue is compounded by the duty and goods and services tax payable on this capital equipment which is referred to below.[80]

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78 WADIR, *Submission* 32, pp 5-7.

79 Dr Walter Green, Communications Experts Group, *Committee Hansard,* 29 April 2005, pp 19-20.

80 Regional Internet Australia, *Submission* 35, pp 1-2.

4.97 In response to questions about the possibility of a wireless broadband service provider, Unwired Australia, rolling out in regional areas, Mr Caldbeck from Dubbo City Development Corporation said:

> … the big issue there has been—and we have had contact from several operators in the wireless field—the backhauls out of remote areas to Sydney and the availability of alternative supplies on backhaul. It is only just recently, with the introduction of companies such as SPTel with backhaul, that wireless operators are getting their confidence level up that they are not going to be subjected to any issues by having an alternative choice.[81]

4.98 That backhaul prices are widely regarded as too high does not mean that they have fallen outside the regulatory net. As the CCC explained, backhaul services had been declared on most main transmission routes where there is no competing infrastructure. The problem, Mr David Forman said, is not that key services have not been declared, but that the access process is not workable in a timely way:

> … I think backhaul is one of these issues that erupt when people see examples of clear pricing or behavioural discrimination. What they are really talking about is transmission and transmission is declared. The difficulty is that, in order to move from the point of declaring the service to controlling the price of the service, you need to go through the negotiate-arbitrate arrangements that exist in this industry. So a customer wishing to acquire backhaul from Telstra goes to Telstra and says, 'Can I please buy some?' They say, 'Yes, you can buy this transmission product.' But, lo and behold, the customer is on a route where there are no competitors, so Telstra say, 'You can have transmission in one colour and it is black, and you can have it at one price and it is this.' That customer has a choice of saying, 'Sorry; I want it in yellow and I want it at a tenth of the price.' Telstra will say, 'Do you? You can have it in black and you can have it at that price. We will go off and have an argument in front of the commission, if you like.' Now, you can go off and have an argument in front of the commission, if you have very deep pockets and a couple of years to wait, and you might get a result that is worth the wait or you might be out of business.[82]

4.99 Mr Errol Shaw from PowerTel made similar observations:

> Probably the most significant demonstration of transmission prices changing was when PowerTel first was formed. What we were going to do was fibre up CBD businesses—we were talking real broadband for Australian business. We tried to acquire intercapital transmission and were stunned at the rates that were being asked. The going rate in the wholesale market when we built our fibre network was about $1.2 million per SDN1 between Sydney and Melbourne. We built our own network and we wholesaled that at $600,000 per annum. We were very happy with the

81 Mr Jeffrey Caldbeck, *Committee Hansard*, 14 April 2005, p. 6.

82 Mr David Forman, *Committee Hansard*, 11 April 2005, pp 22-23.

> margins we were making out of it. Today you can buy that same link for $100,000. That will give you some idea of the change it makes when there is actually a third network owner in place. That goes to the regional transmission and the backhaul, as you call it. There is only one provider of backhaul of any note in this country, and that is Telstra. So if you wanted to negotiate, for parties to negotiate, both parties have to be able to gain something out of it. I am not quite sure what it is that Telstra would see they would be gaining if they negotiated a cheaper price with one of the ISPs. Then, to arbitrate, there is no way that they can challenge the cost base that Telstra can put together and say, 'Here is the cost that we are doing it at.' There is no competition in place. So it is a very murky process that they need to go through.[83]

4.100 It is only a partial solution that backhaul has been declared on most monopoly routes. The problem is not that key backhaul routes have not been declared but that it is difficult to agree on an acceptable price. Speaking of a particular transmission route, Mr Stephen Dalby from iiNet explained:

> … it is declared. There are a few routes that are excised from the declaration but, generally speaking, it is declared. I have had the discussion with the ACCC because, as I said, the [HiBIS] scheme for us disqualified itself because of the ongoing costs associated with backhaul. It is longhaul backhaul, not just the short distance stuff. We can justify the costs of the short distance stuff, it is once you go outside the metropolitan area there is no competition typically. I know there are a few examples where there is but, generally speaking, outside the metropolitan areas there is no competition for backhaul, so you have only one person you can go and see and that is your friendly Telstra account exec. They have a fixed set of prices. It is declared, so the process is you argue with him for six months, because you have to be seen to at least attempt a commercial negotiation, you get absolutely nowhere. You then have to seek a mediator to discuss the matter with which you both mutually agree to and you seek a mediation on the dispute. Sorry, I missed a step. You have to formally lodge a dispute with Telstra, in that case, and you give them X number of days and then they respond—10 minutes before it expires—saying, 'No progress.' Then you seek a mediator. That takes time. You have to engage a mediator and go through a process with the mediator[84]

4.101 Telstra pointed out that competition in backhaul routes including those to some regional areas has increased:

> The level of competition in the wholesale transmission market, in particular, led the ACCC in April 2004 to further de-regulate the inter-capital routes and 14 major capital-to-regional routes.[85]

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83 Mr Errol Shaw, *Committee Hansard*, 11 April 2005, p. 23.

84 Mr Stephen Dalby, *Committee Hansard*, 29 April 2005, pp 47-48.

85 Telstra, *Submission* 25, p. 16.

4.102 The Committee acknowledges that this is correct but notes that it is generally not prices on the competitive transmission routes that have attracted criticism. Rather, it is pricing on transmission routes where there is less competing infrastructure that has generated concern.

4.103 When asked if Telstra's prices for backhaul services were representative of the cost Telstra incurs when it uses those backhaul services itself, Telstra went to some length to point out the complexities of setting prices:

> Elements of the infrastructure used to deliver the Wholesale Transmission service are common to the infrastructure that is used to deliver a broad range of wholesale and retail products.
>
> The costs of the common product delivery infrastructure, as determined by Telstra's management accounting systems are used by both wholesale and retail business units in setting prices for products. The cost inputs for the common infrastructure are consistent for both wholesale and retail products.
>
> Of course different products have differing utilisation of the common infrastructure and also have product specific infrastructure components. In addition, the cost base of every product includes a range of operational, sales, marketing and overhead costs, depending on the nature of the product and the market segments to which it is sold.
>
> Cost inputs are one of many inputs to the final price at which a product is sold. Other inputs include the size of the current and future market for the product, the geographical spread of demand for the product, the nature of the customer segments to which the product is sold, the maturity of the product and the sales channel used to deliver the product to market.
>
> The costs underpinning the provision of Wholesale regional transmission services, while based on complex calculations, are broadly determined by the length of the route, and the bandwidth of the link or links involved.
>
> Costs for the combinations of these factors are the main input, but requirements for all transmission links are also assessed in the context of the existing available capacity on the route coupled with the growth rate of bandwidth consumption, and the need to bring forward additional investment because of the new requirement at hand.
>
> In the case of specific geographic wholesale requirements, additional factors such as committed growth rates in the route bandwidth, other associated current and future committed transmission requirements, additional non-transmission business, and term of the contract can also influence the pricing.
>
> When calculating the cost both retail and wholesale traffic volumes are taken into account. Therefore prices for regional transmission particularly on long routes that carry relatively little traffic are very significantly higher than on routes that carry high volumes of traffic.
>
> Telstra Wholesale usually offers access to transmission at route specific prices – so that its customers benefit from lower prices on offer on shorter haul, high volume routes, but also so that its prices reflect the cost of servicing a specific region.

> Telstra BigPond offers broadband ADSL services, where they are available, at the same price to city, metropolitan, regional and rural customers, irrespective of where they live, delivering tangible benefits to people living across Australia, and particularly in rural and regional Australia. Importantly, Telstra Wholesale provides a wholesale ADSL service at a consistent price across regional Australia, which means that ISPs wishing to service a region have the choice of reselling Telstra ADSL where available, at an affordable price to all regional end users, and at a price which enables them to compete with Telstra's retail ADSL service.[86]

4.104 The Committee is not in a position to question Telstra's calculation of the cost of backhaul. However, it is revealing that, notwithstanding the claimed high cost of providing these services, Telstra has been able to substantially reduce its wholesale prices in response to competition on some transmission routes. It would seem that if Telstra's backhaul prices were not excessively high in relation to its costs, it could not maintain such a reduction and remain profitable on those routes. That it is apparently able to do so on some routes raises at least a suspicion that it is exploiting its monopoly position by charging wholesale prices which are out of proportion to its costs.

4.105 The Committee notes that the ACCC has commenced work to determine if it should provide further pricing guidance on the issue of backhaul and the form this guidance could most usefully take.[87]

4.106 Representatives from James Cook University in northern Queensland told the Committee of their development of their own infrastructure to help them achieve their broadband connection with rural and regional northern Australia:

> [W]ith Queensland government assistance and federal money, we have rolled out a separate fibre optic network. It runs from Brisbane through to Townsville, which is over 1500 kilometres. Goodness knows what the real cost of that is. Not many parties use that network at the moment really, and the very fact that it was cost effective for Powerlink to do that says something about the costs of Telstra over these long hauls—the fact that it is cheaper for someone to build their own network rather than using a preexisting network that is in the ground and for which there is technology freely and easily available to light it up at any capacity. That really seems to me to not be the best way for the country to invest its resources. It indicates that perhaps there is a lack of top-level planning of how the country uses these strategic resources and again there are issues with the market power of the large-scale incumbent.[88]

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86 Telstra, *Submission* 25A, p. 2.

87 Mr Michael Cosgrave, General Manager Telecommunications, ACCC, *Competition and the Need for Regulation,* Speech at the Regional Cities Telecommunications Forum, Sydney, 21 June 2005, at: http://www.accc.gov.au/content/index.phtml/itemId/611729/fromItemId/142.

88 Associate Professor Ian Atkinson, *Committee Hansard*, 21 April 2005, pp 42-43.

4.107 That Telstra's pricing in this instance appeared to have been calculated to impede access to its facilities is demonstrated by its reaction to the competition. Professor Atkinson explained:

> As soon as we had completed that roll-out, Telstra's pricing dropped to where, if it had been at that level initially, perhaps we would not have even considered this five-year endeavour. It has cost goodness knows how much money, in terms of the time it has taken people's staff to write proposal upon proposal and in terms of the actual technical roll-out. Of course, we are relying on further state and federal subsidies to continue with the roll-out, based on the current model.[89]

Mobile termination access prices

4.108 Mobile terminating access service (MTAS) prices attracted some comment during hearings, largely because of the apparent inconsistencies between the wholesale prices that access providers levied on other access seekers and the prices that they appear to charge themselves for wholesale services.

4.109 The ACCC noted in 2004 that MTAS providers have bottleneck control over access to an essential input in the provision of the fixed to mobile (FTM) and mobile to mobile (MTM) calls.[90] Furthermore, providers of mobile terminating access are not constrained in their pricing decisions for the MTAS and have both the ability and incentive to raise the price of this service above its production cost. The ACCC considered that providers of the MTAS are not constrained by the existence of alternatives to the service.[91]

4.110 As part of its review of whether existing mobile originating and terminating access declarations should be extended, the ACCC also determined pricing principles for mobile services. The ACCC assessed current MTAS costs at 12 cents and concluded that wholesale prices should be reduced from 21 cents per minute at 30 July 2004 to 12 cents by 1 January 2007.[92]

4.111 At the same time as mobile carriers were charging 21 cents per minute for wholesale terminating access, they were offering fixed to mobile and mobile to mobile services at retail prices below these charges and, indeed, below 12 cents: that is, at a price lower than only one component of the wholesale cost, suggesting that the cost may be considerably lower than 12 cents. During this inquiry, Hutchison Telecommunications provided the Committee with a Telstra advertisement that listed fixed to mobile calls at 4c per minute when the wholesale cost to competitors of the

89 Associate Professor Ian Atkinson, *Committee Hansard*, 21 April 2005, pp 42-43.

90 ACCC, *Mobile Services Review: Mobile Terminating Access*, June 2004, p. v.

91 ACCC, *Mobile Services Review: Mobile Terminating Access*, June 2004, p. v.

92 ACCC, *Mobile Services Review: Mobile Terminating Access*, June 2004, p. 221.

terminating component alone was 21c per minute. Hutchison confirmed that the cost of terminating access according to the ACCC is 12c per minute.[93]

4.112 Explaining what AAPT perceives as the difficulty in negotiations over pricing of mobile terminating access, Mr David Havyatt said:

> This has been an extremely long, drawn-out process. The ACCC first looked at mobile termination prices in the year 2000. It undertook a review and confirmed that they should continue to be regulated but came out with a very weak pricing principle. It was going to link mobile termination prices to retail price movements, which completely ignored the question: if there were rents there already, how would that eliminate them? Surprise, surprise—we saw retail prices held up so that there was not pressure put on mobile termination prices. So the commission had another look at the question of mobile termination prices, once again concluded there was market power by the mobile operators in the setting of the prices, undertook an analysis primarily using benchmarking but also looking at some of the accounting data they had from the regulatory accounting framework and reached a conclusion that 12c was the top of a cost based price range that they should consider. They thought that moving from the then existing market prices, which were of the order of 21c—and we are talking about before June last year—in one step to 12c would be overly disruptive to the businesses of the mobile networks.[94]

4.113 Mr Havyatt stated that 'Twelve cents was without doubt at the very top end of what a cost based price would be.'[95] He thought that the bottom of the range was about six cents, stating that the ACCC considered the correct range was between six and twelve cents. However, he noted that the ACCC's decision on pricing principles that introduced a staggered reduction had met with opposition:

> It was meant to apply from 1 January 2005 with 3c declines each year. Since that point Vodafone has seen fit to take administrative law action over the pricing principles issue, arguing the commission did not have the power to issue the pricing principle in that way. Optus and Vodafone have each provided undertakings to the commission that are priced significantly above the prices that the commission has indicated are reasonable. I think four parties have notified disputes against Vodafone, and three against Optus.
>
> Meanwhile, we do know that Telstra has certainly made commercial agreements with some parties, including us, about termination prices. Both the Vodafone submission and the Optus submission actually argued that their costs are below 18c but they are not yet prepared to pass on 18c. They are both arguing that, because the commission said there should be a three-year glide path, now the glide path should be at a lower point. As for what

93 Mr Brian Currie, *Committee Hansard*, 13 April 2005, pp 71-72.

94 Mr David Havyatt, *Committee Hansard*, 11 April 2005, pp 36-37.

95 Mr David Havyatt, *Committee Hansard*, 11 April 2005, pp 36-37.

> the consequences are for AAPT, there are specific markets where the integrated players compete for business and we have got evidence that they are competing for that business by quoting a fixed mobile price that is below the price we face with termination. They are able to do so on the basis of the cross-subsidies they get from their mobile business. The ACCC's effective response to that has primarily been to say, 'We understand the nature of the problem, we need to get termination down to cost based prices and this is what we are trying to do for you.' So at the moment you are looking at a marketplace in which integrated players get to internalise these above-cost prices to selectively get to compete below cost in other markets.[96]

4.114 ATUG was critical of the ACCC's limited power in making pricing decisions:

> We agree with some of the other submitters who have concluded that the recent decision on the termination of mobile phone traffic has been an example of the limitations of the powers that are currently available to the ACCC in that it has provided an extremely modest response to an outstandingly well-proven, substantiated and long-term problem which does not affect only one incumbent but is an industry-wide issue. One would have hoped it would have had a much more robust response from a regulator with those responsibilities.[97]

4.115 AAPT claimed that disputes over pricing were delaying the uptake of new services:

> The opportunity to provide voice-over IP is a great development in the industry. It is a service that still resides over the same existing infrastructure but provides the capacity to provide more services over the same infrastructure. To be competitive in the provision of voice-over IP you need to be competitive in the provision of all the voice services. As we are seeing today, the providers who are integrated voice, fixed line and mobile operators face a competitive advantage in the provision of fixed and mobile call prices. While you cannot match that pricing in fixed mobile it is very hard to justify making any investment in call services where you cannot get access to the same input costs on mobile termination. At the moment we believe that voice-over IP has got great potential to transform competition in the fixed line market but is being impeded by the inability of access seekers to get access to mobile termination at cost based prices.[98]

Declaration, investment and regulatory 'safe harbours'

4.116 A recurring argument is that the possibility of new services being declared deters investment in new infrastructure. This is not just because of the pricing constraints that may be imposed, but also because the Part XIC regime mandates

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96 Mr David Havyatt, *Committee Hansard*, 11 April 2005, p. 37.

97 Mr Richard Thwaites, *Committee Hansard*, 11 April 2005, pp 41-42.

98 Mr David Havyatt, *Committee Hansard,* 11 April 2005, p. 33.

access where it may not otherwise have been given, undermining the business case for investment, and imposes compliance costs and delays on providers. The possibility of declaration of a service, therefore, makes the assessment of the return on investment in infrastructure difficult and uncertain.

4.117 This concern has been pressed predominantly by Telstra which, as the owner of the fixed local access network on which the majority of declared services are provided and the company widely seen as the most likely to make further investments, is the provider most affected by declarations.

Regulatory safe harbours

4.118 The original access regime introduced an access undertaking scheme which was intended to increase the certainty for both access seekers and providers about the terms on which access was given. However, in 2001, the Productivity Commission considered that 'mandated regulatory access still presents formidable regulatory risks to investors'.[99] As discussed above, this led to changes to the TPA in 2002 to provide mechanisms that would clarify in advance the regulatory setting for new infrastructure, so as to give potential investors certainty.[100] Telstra outlined the operation of these provisions:

> These mechanisms included:
>
> - **exemption procedure**: a carrier may apply for an exemption from the standard access obligations and the ACCC may grant this, subject to conditions and limitations, if the ACCC is satisfied that the exemption promotes the long term interests of end users;
> - **special access undertaking (SAU) procedure**: a carrier may offer an SAU to the ACCC on various terms and conditions. The ACCC will decide whether to accept the SAU based on whether the terms and conditions are reasonable and consistent with obligations to provide access.
>
> In this manner, significant amendments have been made to Part XIC to provide infrastructure owners with greater certainty so as to promote greater infrastructure investment. Telstra believes these amendments are useful in principle.[101]

4.119 The Committee heard conflicting views about the effectiveness of these amendments. While supporting the amendments in principle, Telstra still saw problems, as illustrated by its experience with the digitisation of HFC cable television network used by itself and Foxtel:

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99 Productivity Commission, *Telecommunication Competition Regulation*, Report No. 16, 2001, p. 294.

100 See paragraphs 4.27 to 4.29.

101 Telstra*, Submission* 25, p. 28.

> An exemption order [in relation to the digitisation of the HFC cable television network] was granted by the ACCC on the basis of an extensive access undertaking. Significant time was spent negotiating that undertaking with the ACCC, including in the context of addressing concerns arising from market inquiries. Digitisation proceeded on the basis of this exemption order at considerable cost. However, the ACCC's decision to grant an exemption was subsequently overturned on appeal, well down the track after digitisation had occurred - exposing the parties to considerable regulatory risk[102]

4.120 As Telstra noted, the Productivity Commission in 2001 used the Telstra/Foxtel digitisation to illustrate the need for increased regulatory certainty.[103] The uncertainty which still exists in the administration of the access regime, according to Telstra, leads to a 'continuing significant regulatory risk in relation to infrastructure investment in Australia'. Telstra argued that improvements were needed.[104]

4.121 While recognising the need for certainty, ACCC Chairman Mr Graeme Samuel stated that the ACCC considers that existing mechanisms are capable of ameliorating this type of uncertainty:

> Regulatory certainty means that they need to be able to know the regulatory rules under which they will operate prior to undertaking investments. That is a perfectly understandable requirement of business. Amendments to the telecommunications provisions in the Trade Practices Act, provide a mechanism for regulatory certainty, and that is by the process of anticipatory undertakings and/or exemptions. Approaches can be made to the commission for those sorts of processes to be put in place and then we will consider those in the context of broad public interest consideration. Public interest considerations will take account of the need for investment certainty, reasonable investment returns and, ultimately, the long-term interests of end users.[105]

4.122 Expanding on this general view, the ACCC referred to the three available mechanisms in the TPA (described above), which provide certainty in cases where investment in infrastructure is being contemplated:

> … we would need to have a look at the case that Telstra brought to us in making the investment. So, in a sense, it would be up to Telstra to choose from the mechanisms that currently exist in the Act. The mechanisms are to seek an anticipatory undertaking—in other words, to basically offer to provide access to competitors on terms and conditions which we would then have to assess—or, alternatively, to seek an exemption. Again, that

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102 Telstra, *Submission* 25, p. 28.

103 Productivity Commission, *Telecommunication Competition Regulation,* Report No. 16, 2001, p. 287.

104 Telstra, *Submission* 25, p. 28.

105 Mr Graeme Samuel, Senate Economics Legislation Committee, *Additional Estimates Hansard*, 17 February 2005, p. 7.

> exemption would have to be in the long-term interests of end users, so we would have to look it against the criteria of the Act. The third possibility is that we could set up an inquiry, which is a normal process, to determine whether that service should be declared.[106]

4.123 The argument that regulatory uncertainty inherent in the access regime impedes investment has led to calls for 'access holidays'. The manner in which such access holidays are implemented was not made clear to the Committee, but the Committee takes it to mean a non-discretionary statutory exemption from access obligations for a pre-determined period.

4.124 Mr Stephen Dalby from iiNet told the Committee that an access holiday for fibre to the home 'is a bit of an ambit claim':

> Telstra has floated that. Optus have their own version of an access holiday. It clearly would be disastrous for competition. From 1990 until now we have been going through this process of slowly getting more and more access to the core network infrastructure to the next size out. The whole next generation for however long—10, 15, 20 years—will mean you can probably pack your bags and go home.[107]

4.125 Mr Ross Kelso, a consultant, also argued that access holidays should not be given to an access provider that was dominant or likely to become dominant:

> [T]he ACCC has granted Telstra and Foxtel anticipatory exemption from access declaration on the basis that they would convert their analogue pay television network and systems to digital working. Not surprisingly, Telstra and Foxtel had previously threatened not to invest in such upgrading and had successfully delayed access for third parties by many years of litigation.
>
> Although that case is now history (with third party access to the Telstra/Foxtel network unfortunately rather unlikely to ever occur), we must re-examine the fundamental objective behind the Telecommunications Competition Act 2002 (No. 140) and ask the question – should every access provider gain benefit (by way of greater investment certainty) from such amendments to the telecommunications regulatory regime?
>
> On the premises that:
>
> • Effective competition between telecommunications carriage and service providers needs to be facilitated by the government as the highest priority;
>
> • As a dominant access provider of core infrastructure, Telstra has a long track record of lessening competition by inhibiting access for other providers;

106 Mr Joe Dimasi, Senate Economics Legislation Committee*, Additional Estimates Hansard*, 17 February 2005, p. 7.

107 Mr Stephen Dalby, *Committee Hansard*, 29 April 2005, p. 51.

> • Any threat by Telstra not to invest in new infrastructure that exploits its existing areas of dominance (eg. in the customer access network, involving cables, pipes and pits; and in the rural trunk network) runs directly counter to the interests of its shareholders in the long term and should not be taken seriously;
>
> I submit that the [2002] amendments to Part XIC … should not apply to any access provider deemed to be dominant, or likely to become dominant, with regard to creation of the facilities or services in question.[108]

4.126 Mr Kelso went on to state:

> In contrast, competitive telecommunications carriage and service providers would remain able to take advantage of any exemptions from access declarations and approvals of undertakings granted by the ACCC for facilities or services not yet declared or supplied. In so doing, the competitive 'playing field' would be made more level for non-dominant players in the Australian telecommunications industry by denying dominant players an unnecessary 'free kick'.[109]

'Dark fibre'

4.127 Another issue which was raised with the Committee was the presence of infrastructure which is not being used in the form of 'dark fibre', that is, fibre optic cable which is not activated. Witnesses at the Dubbo hearing were concerned that they believed dark fibre was laid through the centre of Dubbo and nearby Narromine. Given the difficulties reported in that region in terms of broadband access, the Mayor of Narromine Shire Council stated:

> That represents an enormous opportunity for our local residents and businesspeople to access high-speed internet and communication services. Why does what is essentially a taxpayer owned company invest huge amounts of money in infrastructure and then not make it available to the very people who pay for it? Where is the regulatory power to ensure that infrastructure such as this fibre-optic cable is switched on and made available to communities and other telecommunications providers so that adequate services can be delivered?[110]

4.128 The general manager of the Narromine Shire Council stated that 'We have asked questions from a regional basis and Telstra have no answer'.[111] The Committee sought clarification from Telstra and was given only very general information in response.

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108 Mr Ross Kelso, *Submission* 31, pp 2-3.

109 Mr Ross Kelso, *Submission* 31, pp 2-3.

110 Mr Robert Barnett, *Committee Hansard*, 14 April 2005, p. 29.

111 Mr Paul Bennett, *Committee Hansard*, 14 April 2005, p. 31.

4.129 Mr Bill Scales explained that the presence of cable does not necessarily mean it is ready to be activated. Dark fibre is cable that has been laid to accommodate future demand or serve as a back-up if activated cables are damaged:

> It is really redundancy built into the system for future need. … It is effectively a line of fibre, it is not activated and it will be used at some point in the future.[112]

4.130 Mr Scales went on to explain that other vital infrastructure may be missing, which would require significant additional investment:

> [L]aying of cable is not where the largest part of the cost will be. Often it will be the provisioning of other elements of the network.[113]

4.131 In response to a question on notice on this issue, Telstra provided very little additional information:

> Telstra has over 3.6 million kilometres of optical fibre in its network connecting the majority of population centres, and these contain varying degrees of dark fibre, from none or very little in some cables to fairly large proportions in other cables.[114]

4.132 While there may be legitimate infrastructural and/or commercial reasons for not opening up dark fibre in these areas, Telstra's inability or unwillingness to provide more information is disappointing in light of the complaints from those living in rural and regional areas.

Conclusion

4.133 The Committee has queried how successful the access regime has been in promoting competition in services markets and encouraging the efficient use of, and investment in, infrastructure.

4.134 The Chairman of the ACCC recently observed that:

> … the competition that has emerged from this initial process [of regulation] continues to be heavily dependent on access and re-sale arrangements with competitors simply buying space on the Telstra network and competing on price rather than building their own facilities and offering different products and better performance.
>
> In the absence of any significant national roll out of competing infrastructure, it has not been possible to fully realise the benefits of more sustainable competition across the entire telecommunications sector. As a result, maintaining competition has required an even greater reliance on

112 Mr Bill Scales, Group Managing Director, Corporate and Human Relations, Telstra, *Committee Hansard,* 4 May 2005, p. 74.

113 Mr Bill Scales, *Committee Hansard,* 4 May 2005, p. 76.

114 Telstra, *Submission* 25A, p. 3.

> access regulation – instead of the winding back that was envisaged when telecommunications was opened up to full competition.[115]

4.135 The evidence the Committee has received suggests that most of the competition at the services level has been in metropolitan areas: there has been far less in outer metropolitan and regional areas.

4.136 While there has been some competition at the facilities level, this has largely been in access networks in some business districts and in transmission infrastructure between major metropolitan markets. There is also emerging competition in ULLS services as some firms install their own equipment in Telstra exchanges.

4.137 Some of these outcomes might be expected. Some infrastructure is regarded as having natural monopoly characteristics and is therefore less likely to be efficiently duplicated. Facilities based competition might be expected to be more prevalent in markets without that characteristic. However, there is evidence of under-investment in facilities where it might be expected and overbuilding of infrastructure in others.

4.138 That widespread facilities competition has not emerged may simply be the outcome of commercial considerations. However, evidence before the Committee suggests that deviations from what is expected may reflect deficiencies in the regulatory environment and impediments created by owners of bottleneck facilities. In the Committee's view, infrastructure investment by competitive carriers in the Australian telecommunications sector has been inhibited by the shortcomings of the current regulatory regime.

115 Mr Graeme Samuel, speech to Australian Telecommunications Users Group, 10 March 2005.