

**Competitive  
Carriers'  
Coalition Inc**

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**Revitalising Competition in Australian  
Telecommunications**

**Proposals for Policy Reform**

**Discussion Draft**

**January 2005**

## EXECUTIVE SUMMARY

**Problem:** Telstra's domination of most communications markets and ability to leverage market power across markets. This is a consequence of its structure. It results in the failure of competition affecting all consumer groups, especially residential and non-metro.

**Ideal Solution:** A form of structural separation of Telstra.

**Near Term Realistic Aim:** To create a regulatory package that delivers as much of the benefit as possible that would be derived from structural separation, while acknowledging the limitations of anything short of real separation to address the core incentives of Telstra to favor itself.

**High Level Model:** Equivalency-based Internal Operational Separation of Telstra. This is a model where Telstra supplies inputs to itself on the same basis as it supplies them to its competitors (i.e. wholesale customers and access seekers)

**Points of Internal Separation:** Input definitions to be finalized. Initial thoughts are that all infrastructure should be managed within the wholesale part of Telstra. This would prevent Telstra from constructing products that are different from those able to be offered by competitors by defining some network-based capabilities as "belonging" to a retail group. This is very different from the changes proposed by Telstra itself in an announcement to the ASX on 6 December 2004. A key issue which will need to be resolved is whether separation should be constructed around those products already defined as core services or if this would be too restrictive. Also, the convergence of core network technologies (e.g. voice over internet protocol, VoIP) and separation of services into applications makes defining these boundaries more difficult as time moves forward. This is a major point requiring further CCC consideration.

**Regulatory Discipline:** The most serious risk associated with self imposed internal separation is that it is potentially reversible. Therefore, there needs to be a remedy that the regulator can rely on to maintain a discipline over Telstra's future actions. To overcome this the ACCC should be vested with a divestiture power (to complement the existing remedies for proven anti-competitive behaviour), which the ACCC could seek application of through the Federal Court. This remedy could be integrated into the existing Part XIB and XIC provisions of the Trade Practices Act. This is an area requiring further CCC investigation.

**Other Policy Changes:** In the broader context, the appropriate regulatory package could include changes to measures that are not strictly related to the structural problem. For example, there is a need for significant changes to the arrangements around price setting/undertakings processes. This might be the abolition of undertakings or for the ACCC to be given the power to vary and impose undertakings.

**Confronting the Regional Dilemma:** The CCC supports the retention of a Universal Service Obligation (USO), but the abolition of the present USO levy for the reasons given by DCITA last year in a report which considered options for improving the USO scheme<sup>1</sup>.

In its place, once the competitive environment has been strengthened in the ways described above, a Network Infrastructure Fund (NIF) should be established, funded at least in part by the USO contributions of the non-Telstra carriers. The purpose of the fund would be to address the issues arising from the Estens Inquiry and to provide one-off funding to upgrade the network infrastructure, particularly in regional and rural areas. Once basic infrastructure has been raised to an acceptable standard, and the access issues of today have been resolved, competition and all the benefits it brings should begin to spread to rural and regional communities.

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<sup>1</sup> Review of the Operation of the Universal Services Guarantee obligations and Customer Service Guarantee, DCITA, April 7, 2004

## **INTRODUCTION**

The CCC is an association representing a group of non-dominant telecommunications carriers in Australia. The CCC stands apart from other representative groups because it speaks exclusively for carriers and carriage service providers that have invested in building their own competitive infrastructure, rather than simply trying to resell Telstra products.

Its members have invested over \$4 billion in competitive infrastructure and have been at the forefront of driving competition in markets as diverse as 3G mobile services, corporate data and voice services, wholesale transmission and residential Internet and voice products.

This document has been produced in the context of the public debate about the regulatory environment that would be appropriate.

This document is a summary of what the CCC believes is at the core of the failure of competition to develop as was planned in telecommunications at the time of the major reforms of 1997, and introduces what the CCC believes is a workable platform for reform of the regulatory and policy framework to overcome this failure.

It is not intended to be comprehensive, but does provide an overview of the major elements of reform that the CCC believes are both necessary and workable in the near term. The CCC believes most of the reforms can be achieved with the policy structures that exist today. The CCC will publish more detailed papers on various elements of this platform.

## THE PROBLEM

It is now almost universally acknowledged that competition has failed to develop as was intended when legislation designed to facilitate full competition was introduced in 1997.

Telstra's dominance in communications markets was expected to recede as competition became established. It was intended that the regime requiring Telstra to give wholesale customers access to the monopoly elements of the former public network, alongside sanctions for identified anti-competitive behaviour, would be sufficient to provide new entrants with the ability to invest rationally. This approach was intended to allow new entrants to reach customers on equitable, competitive terms without having to replicate the entire existing infrastructure, focusing investment and energy on creating new and innovative products, services and network elements.

This approach was adopted in numerous countries through the 1990s. However, the consistent evidence from Australia and overseas is that in countries where vertically and/or horizontally integrated incumbents were left in place, those companies have been able to systematically frustrate competition by denying equitable access through a wide variety of mechanisms, including inaction and regulatory "gaming" activities.<sup>2</sup>

The result has been that regulatory intervention has become ever more complicated, intrusive and pervasive as regulators fight a losing battle to make incumbents behave as it was intended they should.<sup>3</sup>

This has in turn created regulatory fatigue in the industry affecting not only competitors but also consumer groups, user groups, and policy makers and regulators. The participant least affected by this fatigue appears to be Telstra because it has the resources to participate in whatever processes are in train and shape outcomes from them.

As discussed above, other jurisdictions have experienced the same pattern of behaviour, and in the UK, where a major review of competition is presently underway, the regulator, Ofcom, has concluded that "the status quo is not an option".<sup>4</sup> The CCC believes that in Australia, also, another round of reforms based on an attempt to make the access obligation and behavioural sanctions approach work is doomed to failure.

The ACCC, the Productivity Commission, the National Competition Council and many others have consistently identified Telstra's structure and the incentive for it to favor itself over competitors when providing access to bottleneck facilities as the core problem.<sup>5</sup> The next round of regulatory reforms must accept that the access/behavioural approach needs to be supplemented by actions that directly go to the structure of Telstra.

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<sup>2</sup> Ofcom Strategic review of Telecommunications Phase Two Consultation Document November 18 2004

<sup>3</sup> Ed Willett: Gaining a Competitive Edge in the Telecom Sector. Speech to AFR Telecom Summit, November 15 2004

<sup>4</sup> Ofcom *ibid*

<sup>5</sup> ACCC Emerging Market Structures in Communications Sector Report to the Minister Report, June 2003

## Measuring Telstra's Dominance

Telstra's Share of the Total Australian market for:

Directly Connected Lines: 89%

Local Call Revenue: 81%

Total Industry Profits: ~95%

Total Industry Voice Revenue: ~75%

Fixed to Mobile Revenue: 75%

Sources: ACCC, Budde.com.au

## WHO PAYS THE COST OF MARKET FAILURE?

Telstra has on occasion responded to the calls for reform by competitors by claiming this was self-serving. The CCC accepts that the suggested reforms would be beneficial to its members and to other competitors. However, it makes two points:

- *The outcomes that the CCC has argued for is entirely consistent with Government policy, which is intended to create workable, sustainable and effective competitive relationships in telecommunications markets, and;*
- *The cost of the failure of competition is borne by all Australians through higher prices, poor services, a lack of innovation and retarded national economic performance.*

The OECD's observations make it clear that the Australian experience is completely in keeping with the actions that could be expected from an integrated business such as Telstra, which is motivated to direct its energies to prevent change and development in the markets in which it operates. In particular the OECD states:

*'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 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.'*<sup>6</sup>

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<sup>6</sup> OECD, *Restructuring Public Utilities for Competition*, OECD, Paris, 2001, p.17.

Inefficiency is the inevitable companion of a failure of competition. Inefficiency must be paid for, and the list of those who pay for the lack of effective competition in telecommunications includes:

#### *Investors*

Since the advent of competition there has been enormous investment in telecommunications infrastructure in Australia by investors lured by the promise of fair access and the opportunity presented by Telstra's poor reputation for customer focus. However, returns on those investments have been disappointing as the competition framework has been shown to be far less effective than was intended. This has created a vicious circle because investment for infrastructure-based business models has come to be seen as being more risky, when in fact it is efficient investment in infrastructure that should provide the basis for sustainable, effective competition and which regulation should seek to encourage.<sup>7</sup>

#### *Consumers*

Residential consumers have enjoyed reduced prices and improved services since the introduction of competition, but relative to falls in some other countries, improvements in services and prices for residential consumers have been poor. Recent evidence suggests that prices have begun to rise for services to consumers where competition is weakest, such as phone calls from fixed line services to mobile phones. It is clear that Telstra has responded to competition in corporate markets by cross-subsidising from ordinary consumers, undermining competition in corporate markets in the process.<sup>8</sup>

#### *Rural and Regional Customers*

Despite billions of dollars in tax-payer funded subsidies to non-metropolitan areas, services to people living outside of cities have been falling steadily behind. Telstra remains a monopoly provider in most of the regional areas of Australia and, unfortunately, subsidies (in the form of levies imposed upon non Telstra carriers) have tended to entrench this position. Competitors continue to shy away from regional areas because competition has proved so vulnerable even in high population density metropolitan areas that there is a feeling that entering regional Australia would be a commercial disaster in the present regulatory environment. The unmitigated failure of the Australian Communications Authority's USO contestability trials is further proof of this.

#### *National Economic Growth*

There is clear evidence that Internet connectivity followed by higher bandwidth, always-on services have given a substantial boost to business productivity. Conservative estimates by the Centre for International Economics of the potential impact of the deployment of a true broadband access network in just one region in Queensland suggest a statewide benefit of \$2.5 billion to \$3.2 billion over 15 years, with the greater return under a more competitive set of ownership arrangements.

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<sup>7</sup> Ed Willett: Challenges in Telecommunications Competition and Regulation; speech to SPAN June 25 2004.

<sup>8</sup> ACCC Annual Reports for Telecommunications 2002-03

However, Australia is again lagging the world in moving to higher download speeds due to a lack of competitive entry and investment.<sup>9</sup>

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<sup>9</sup> Centre for International Economics: Broadband, Competition and Growth. December 2004



### **The Price of Failure: How the Inefficient Telco Markets Cost Australia**

- **The problems of service failure:** There are many areas in which Telstra's service offerings or product quality are below customer expectations and international standards, both in the wholesale and the end-user markets. This is particularly apparent where Telstra is effectively the sole provider particularly in most of regional Australia and in the broadband market. In both cases Telstra exhibits classic monopoly behaviour in restricting output. In neither case is facilities based competition a complete response, even though some alternative technologies (satellite and wireless, respectively) may address the problem at the margin. The core of the problem, not its margins, must be addressed.
- **Stifled economic outputs:** As noted above, Telstra's dominance is illustrated clearly by its behaviour in restricting output. This is clearly the case in the broadband market. Telstra has successfully argued against general access to its HFC cable network, thereby restricting potential output to the market, and, until its inadvertent reduction of both wholesale and retail low-end xDSL broadband offerings, restricted broadband take-up in the general market.
- **Lack of innovation:** The extent of Telstra's innovation in its own retail product offerings is a matter for debate. The more important issues are the extent of its innovation in wholesale markets and, the ability of service based providers (who are wholesale customers of Telstra), to innovate in their approaches to market. Regulators have had to force Telstra to develop its wholesale offerings, and Telstra has adopted a minimalist approach to protect its own retail businesses. As a result, service based providers have been seriously constrained in using unbundled network elements to develop innovative and different retail products and services. Telstra's integrated operations are therefore a barrier to innovation across the industry.
- **International competitiveness:** The implications of Telstra's dominance and the retarding effect that this has on broadband deployment and adoption and on innovation in Australian telecommunications markets must be seen in the broader context of Australia's international competitiveness. Increasingly, Australian products and services are defined or delivered with growing Integrated Computing and Telecommunications (ICT) content. This is occurring as the growth in services trade associated with transaction-based and knowledge-based industries, capable of being marketed and delivered electronically is increasing. ICT maturity is therefore increasingly a critical part of national competitive advantage.
- **High cost of regulation and uncertainty:** The regulatory access regime embedded in the 1997 Act gives primacy to bilateral negotiations reflecting a preference for relationships that mirror commercial bargaining. Regulatory correction is essentially a corrective once problems have arisen. This regime was experimental in 1997, and is a failure in 2004. It results in high regulatory transactional costs, exacerbated by exploitation of many gaming opportunities. The cost of not requiring the ACCC to determine access prices (other than in response to disputes and undertakings) is to increase uncertainty and delay. The effect of high regulatory cost and uncertainty is disproportionately heavy on smaller, less-resourced operators, and has least relative impact on Telstra itself.

## **IDEAL SOLUTION**

Clearly, structural separation of Telstra is the only guaranteed method of removing the internal incentives in the organization. This would be consistent with reforms in other utilities such as gas and electricity. However, it is not clear what would be the most effective form of structural separation. This is particularly vexed in the case of Telstra because the level of integration is so extensive and far reaching, covering everything from content, to alternative delivery platforms such as Pay TV cable, wireless and mobile.

The CCC has advocated structural separation in the past but has always said that the form of it would require considered, independent investigation. In stark contrast to countries like the UK where the regulator is undertaking a comprehensive review of structural arrangements in telecommunications, Australia has never had such a debate.

The CCC completely rejects as self-serving and non-sensical recent suggestions by consultants to Telstra, NECG, that the cost of simply investigating these issues would be too high and that they would encourage “rent seekers” to argue their cases. The ACCC’s rebuttal of this argument supports the CCC’s view<sup>10</sup>. The opportunity cost to the economy of the inadequate competition presently affecting the communications sectors can safely be estimated in the billions of dollars a year. The CCC submits that the reaction of Telstra and its representatives to suggestions that an inquiry into structural issues is warranted indicates how sensitive they are to what such an inquiry would find.

However, the CCC accepts that a thorough analysis of structural separation followed by an implementation of recommendations could take years to effect. This clearly creates an opportunity for consideration of nearer term actions that might deliver the bulk of the benefits of such reform in a more timely manner.

## **NEAR TERM STRUCTURAL PROBLEM REMEDIES**

While only structural separation can remove the incentive for Telstra to favor itself over competitors, other arrangements can be considered that might be effective in preventing it acting on this incentive or, if it does, make it easier for the regulator to act in response.<sup>11</sup>

The CCC submits that a model of internal operational separation based on “equivalency” of treatment between Telstra retail activities and other carriers, as recently advocated by the ACCC, should be the objective of such an approach.

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<sup>10</sup> Ed Willett, ACCC Commissioner, submission to Productivity Commission NCP Inquiry November 24 2004

<sup>11</sup> ACCC submission to Productivity Commission NCP inquiry December 10 2004.

The CCC sees an effective set of internal arrangements as being far removed from the present internal Telstra arrangements, even after recent announcements by Telstra that it would create a new position of Group Managing Director Wholesale which would report directly to the CEO. The CCC notes that this reporting arrangement has existed previously in Telstra and did not resolve the problems of integration at that time.

There is also some confusion about the relationship between Telstra Wholesale and Telstra's various retail businesses that perhaps leads to misunderstandings of the depth of the problems faced by access seekers.

Telstra Wholesale does not supply Telstra retail with inputs. Telstra Wholesale is simply a sales group that sells a range of products to other carriers. These products might rely on the same inputs that are supplied to Telstra retail businesses, but they are not "sold" by that group to Telstra retail businesses. 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.

Clearly, a first step in creating an effective internal separation regime is to ensure that the network infrastructure is clearly controlled and operated by a wholesale group, and that the systems underlying the price, terms and conditions of access are the same for Telstra as for other carriers.

But to deliver true and effective equivalency, access for competitors needs to begin at the point of product design. This is not just needed to ensure that Telstra does not favor itself by designing product to which access is unnecessarily complicated or difficult. It is also crucial if innovation and national benefit are to be maximized as the next generation of technologies is deployed in Australia

**Toward Equivalence:** To ensure Wholesale Customers have access to the same set of wholesale products as the integrated incumbent they must have access to:

- Product that has the same features, functionality and quality
- Processes for ordering, provisioning, fault management and forecasting that use the same systems
- Prices that are non discriminatory across all input elements
- Product Development relationships that allow them input at early stages, and equal opportunity to stimulate new, innovative product design and development

## THE COMPLICATION OF EVOLVING TECHNOLOGY

A number of operators are implementing Next Generation Networks (NGNs) around the world. Also, it has been reported that Telstra is trialing Internet Protocol (IP) voice services and will eventually implement a fully-integrated network architecture. NGNs deliver convergence between the traditional world of PSTN and the new world of data networks. From an operator's perspective, NGNs provides a vehicle of migrating old world to new world and delivering substantial cost savings due to economies of scale inherent in a single converged network.

Converged network services include fixed voice over IP (VoIP), portable voice/data, mobile voice/data services and content services (including broadband internet access) delivered on the integrated access services. These services include terrestrial and radio based broadband access services. An example of a converged network deployment is British Telecom's '21<sup>st</sup> Century Network' (21CN). BT's 21CN is being scrutinized by OFCOM in the context of equitable access and interconnection. The essential principles that OFCOM have a particular interest include:

- Depth of access
  - Geographic depth, and
  - Interconnection layer (basic transport or higher application layers)
- Equity of access

The scope of BT businesses are certainly not as extensive and are not integrated to the same level as Telstra's businesses that include fixed, mobile, data and Pay-TV. Nevertheless, Ofcom are sufficiently concerned about equitable access to the BT's NGN to have initiated a process to resolve the potential for access to be frustrated in new ways.

This is an issue of urgent concern to Ofcom despite the fact that BT in the UK is integrated across far fewer vertical and horizontal markets than is Telstra in Australia.

The convergence of broadband fixed and mobile networks is a tremendous strategic advantage for an operator such as Telstra that remains one of the most integrated full service carriers in the world. With the evolution of new converged ICT services and content it is essential that access and interconnection to these services are equitable, and that NGNs are designed with this in mind.

## **CHANGING BEHAVIOUR – THE NEED FOR A NEW REGULATORY DISCIPLINE**

Ofcom in the UK recently released its Phase 2 discussion paper as part of its extensive strategic review of telecommunications in the UK. It noted that:

*“Delivery of equality of access ... has two components: equivalence at the product level and clear behavioural change by BT.”*

The two biggest weaknesses in a self imposed internal operational separation solution are:

- It is easily reversible, and;
- It does not remove the fundamental incentive for Telstra to discriminate against access seekers. That is, behavioural or cultural change would not necessarily follow simply because Telstra was restructured internally.

Unless it was enshrined in great detail in legislation, the management of Telstra could restructure at any time, or over a period, to undo or dilute the internal operational boundaries or blur the points of separation.

Alongside this, and even with highly prescriptive legislation, the continued existence of the incentive to favor itself by virtue of the integrated ownership of wholesale, retail and other business elements creates a motivation for Telstra to find ways of diluting the effectiveness of the arrangements.

The ACCC itself noted this limitation to the effectiveness of internal operational separation in a submission to the Productivity Commission in December 2004 in the following terms;

*“It is anticipated that operational separation would enable blatantly discriminatory or collusive behaviour to be more easily identified. However, as with accounting separation, the underlying incentives would not be expected to change significantly, since the separate business units would ultimately be answerable to a single board of directors.”*

In other words, internal operational separation should make it easier to identify and prove anti-competitive conduct, but would not remove the incentive for such behaviour. There is a real risk that, over time, the arms race between the regulator and Telstra would re-emerge, with Telstra developing more sophisticated ways of avoiding regulatory intervention while the ACCC developed more regulatory tools to stop it.

The problem of the apparent inability of the available sanctions in the TPA to provide an effective deterrent to this behaviour would therefore remain.

The experience in wholesale and retail ADSL markets, where Telstra has had imposed on it competition notices in 2001 and again in 2004/05, suggests that if Telstra believes the commercial benefit is great enough it is willing to risk the cost of the highest level of regulatory intervention in the ACCC's armory.

At present, a competition notice and the potential for subsequent court action is the highest sanction that the ACCC can impose on Telstra for anti-competitive conduct. While the penalties attached to this process provide for significant fines of up to \$10 million and \$1million a day for proven breaches, it is of serious concern that a competition notice has been in place against Telstra for nine months in relation to ADSL markets, and still shows no clear signs of being finally resolved. This suggests that Telstra is willing to accept the risk of these heavy fines as a cost of doing business and that they are not an effective deterrent to it continuing to act in ways the ACCC believes breaches of the Act.

In other words, Telstra's integrated structure means it faces weak incentives to comply with the intention of the policy regime by treating wholesale customers equitably, while the sanctions it faces for failing to comply do not appear to provide sufficient disincentive to its attempts to avoid compliance with this intention.

The CCC believes that this demonstrates a need for an additional external discipline to act as a countervailing disincentive to the incentive to act anti-competitively created by Telstra's integration. It submits that this should take the form of the amendments to the Part XIB and Part XIC telecommunications-specific powers in the TPA to add a new remedy allowing the ACCC to seek a Federal Court order that Telstra divest itself of certain assets or businesses.

Such a remedy should be an effective deterrent because it would address the very source of the incentive to Telstra to favor its own retail activities. Unlike pecuniary penalties, the management of Telstra would have to consider that the consequences of their actions, if found illegal, would go to the structure of the business and could not simply be treated as a calculated risk by offsetting potential fines against revenue or profit gained.

Regulatory mechanisms aimed at resolving structural failure in markets are not novel. A divestiture "trust-busting" power has existed in the US going back to the Sherman Act in 1890 and has been exercised on occasion by courts to break up monopolies in important industries such as oil, and telecommunications. The UK has an established process of investigating markets under the Enterprise Act to determine if they are structurally uncompetitive and then referring the findings to the Competition Commission for action.

In Australia, the ACCC can reject proposed mergers on the basis that they would diminish competition. That creates the seemingly perverse situation that the ACCC could prevent Telstra from being created by a merger if it thought it might harm competition, but cannot act to require it to divest itself of assets even if it proves it is acting anti-competitively.

It is important to note that in the UK where a process of internal operational separation of BT similar to that being discussed in this paper is being proposed by the regulator, Ofcom, there are processes for structural separation already in place under the Enterprise Act.

The CCC believes an external discipline in the form of a remedy that could lead to an imposed structural rearrangement is crucial to ensuring that Telstra is motivated to change its behaviour.

## **OTHER REGULATORY MECHANISMS**

As discussed above, the experience of the past eight years has both exposed the fatal flaws in different elements of the existing regime and led to the development of great complication as attempts have been made to overcome those flaws.

### **Undertakings**

The CCC submits that one mechanism that is in need of fundamental re-engineering is the undertakings process.

While intended to provide clarity and certainty in pricing on an industry-wide basis, undertakings have provided quite the opposite. 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.

The CCC believes that undertakings and indicative prices should be abolished and be replaced with a formal price setting regime, as many other jurisdictions have done.

Alternatively the undertakings scheme could be changed to be more consistent with the way they are applied in the energy markets. In those markets, the ACCC can both require an access provider to make an undertaking, and can vary or entirely replace an undertaking with one of its own.

Such a change would have several positive effects. It would:

- discourage the submission of undertakings as a tactic to delay the resolution of a pricing issue;
- prevent an access provider from submitting serial sets of undertakings that varied only slightly, but which tied up the resources of the ACCC and industry by requiring individual assessment, and;
- allow the regulator to initiate action that would quickly bring certainty to pricing and conditions in the market for particular services.

The CCC believes that this would be a straightforward way to create a more effective system of settling the perennial access arrangement disputes in Australia, and is a mechanism that has already been implemented in energy markets in Australia.

### **Bundling of telecommunications services**

Bundling is the other most serious matter requiring regulatory attention. The bundling by Telstra of core services (i.e. monopoly or bottleneck services or facilities) with contestable services at prices that are significantly discounted against the market for individual services, and often at prices that raise questions about margin squeeze issues, has become endemic.

Telstra would be able to use bundling as a first line means of mitigating the effects of internal separation. Therefore, the CCC proposes that where Telstra bundles such services, that Telstra Wholesale be required to provide a bundle of services equivalent to any retail bundle offered by Telstra at a discount to the retail price. Such a discount would be set at an appropriate commercial rate. An efficient competitor should be able to make a margin on this product and the requirement to provide it would act as a deterrent to Telstra attempting to use either anticompetitive cross subsidisation or margin-shifting to undermine competition.

### **SPREADING THE BENEFITS – RESOLVING THE BUSH DILEMMA**

If the above reforms were implemented to resolve the fundamental problems in competition, the platform would be in place to allow for a serious attempt to finally resolve the issue of inequity faced by consumers in rural and regional areas. In those circumstances, the CCC advocates the establishment of a Network Infrastructure Fund (NIF) supported by the transfer of the USO levy payments other carriers make to Telstra into a special purpose fund.



The purpose of the fund would be to address the issues arising from the Estens Inquiry and to provide one-off funding to upgrade the network infrastructure, particularly in regional and rural areas. The fund would also be used to back-out the USO credit levy payments over a period of say 3 to 5 years.

Such a scheme would recognize the unique nature of supplying services to areas which are by and large uneconomic for carriers (other than Telstra) to invest in infrastructure at least under the current regime. Therefore initially at least, this would be more of a service based model rather than an infrastructure model, which would require strengthening of the access regime.

Under such a scheme Telstra would retain ownership of the access network but the government or a combination of federal, state and local governments, (as policy makers not shareholders) would determine a plan for network upgrades to facilitate the supply of improved services such as broadband. All carriers including Telstra could then compete for supplying USO services and would obtain access to the network subject to the regulatory access regime, which would ensure equitable terms and conditions between competitors. This would promote competitive entry into USO markets thereby allowing competitors to establish a sufficient customer base necessary to support competitive infrastructure roll out in those areas. Telstra would remain carrier of last resort.

The Government should not attempt to repeat the outcome of T2 in which Networking the Nation (NTN) funds were allocated without enduring infrastructural benefit.

The NIF should be augmented from USO levy contributions for a period. These transfers should not go to Telstra's consolidated revenue, but should be ear-marked for regional network upgrades

The CCC would be supportive of USO contributions going to upgrading Telstra's regional network only if it was confident that other changes in the legislative and regulatory regime made it possible for competitive access to be gained.

## **CONCLUSION**

The CCC intends to follow this overview paper with more detailed papers expanding on particular issues and elements of the CCC proposals.

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