

Future Scope of the Local Carriage Service Declaration

Response to the ACCC Discussion Paper - August 2000

Macquarie Corporate Telecommunications (MCT) welcomes the opportunity to comment on the Commission's Discussion Paper regarding the future scope of Local Carriage Service Declaration. MCT is concerned however that at this stage the Commission is not proposing a full public inquiry.

In principle MCT supports the withdrawal of unnecessary regulation wherever possible, including access declaration. However that withdrawal must be based on sound economic principles, based on the facts and circumstances of each case and supported by rigorous analysis of the LTIE. That is, the basis for declaration should be equal to de-declaration in all respects including a full public inquiry. It is also difficult to see how the LTIE could be determined when end users are not directly consulted through a public inquiry process.

Of course if there were to be a large number of applications there would need to be a practical application of de-declaration, like a class exemption. However as this is clearly intended by Telstra to form the basis of further applications it would seem inappropriate to by-pass the public inquiry process.

Similarly it seems strange that Telstra has not availed itself of the opportunity to utilise the processes of the TAF which it has so enthusiastically supported in the past. Presumably a de-declaration proposal supported by the TAF could be fast tracked through the Commission. Even without the TAF's agreement, Telstra has supported the view that the TAF processes educate the broader industry on the issues and provide a forum to reach an understanding of the proposal. MCT is surprised that Telstra is not being consistent in its treatment of the TAF. Indeed the application for a de-declaration attached to the discussion paper stands in stark contrast to the detailed proposals for declaration that have been developed through the TAF. It is important that regulatory decisions of this nature should be made on a transparent basis so that the industry and other interested parties can fully participate in the debate.

MCT would suggest that before the Commission investigates this request any further it refer the matter to the TAF.

Should the Commission chose not to follow the TAF path, then MCT would welcome the opportunity to submit a further submission. This submission briefly outlines the importance of the local carriage service, the state of the market generally and in CBDs in particular, and suggest some criteria that the Commission could take into account before making a de-declaration decision.

In keeping with MCT's commitment to open discussion and public accountability this submission is available to the public on its website www.macquarie.org.au.

Importance of the Local Carriage Service

MCT believes that access issues, including declaration, must take the commercial needs of the access provider into account in order to ensure that efficient investment levels are made and commercial risk is fully taken into account. These needs must be balanced against the benefits of

competition that will arise from declaration. Having said that, MCT has supported the Commission's decision to declare Local Carriage Services (LCS).

In MCT's view, premature retraction or curtailing of the local carriage service declaration would not only have an adverse effect on service providers and end users by failing to allow competition in the retail component of the supply of local carriage services, but it is also likely to retard or destroy the likelihood of alternate delivery mechanisms being developed. That is, in the absence of access to the declared local carriage service providers will be denied the vital "stepping stone" towards establishing themselves as facilities based competitors for the provision of local call services either through utilisation of the unbundled local loop product or through use of the local PSTN access product.

MCT's support of LCS declaration is based on a number of issues that impact on related markets. The issues that are of fundamental importance are:

- The ability of the customer to deal with a single supplier for the receipt of all its telecommunication services with the advantages of integrated operation, billing and account management.
- The ability to build up a customer base and establish brand recognition before committing to investment in facilities.
- The related ability to the build information on the needs and requirements of the potential customer base.

These remain very much live factors and it is difficult to see how the fundamentals of the market have changed in the short time since the declaration. Even more difficult to understand is how the untested implementation of the ULLS will impact on these factors until such time as there is a wide take up of ULLS services. The Commission is well aware of the course of problems and delays encountered by operators who have attempted to obtain access to Telstra's ULL product. These problems have resulted in the Commission having to intervene to produce pricing principles for the ULL service. Meaningful utilisation of the ULL service remains, in MCT's view, some considerable way off.

State of the Market for LCS

MCT does not provide its own voice services in CBDs and therefore has limited comments on the ability of carriers to provide these services. However MCT is a large purchaser of a wide range of telecommunication services in CBDs, including local carriage service and would like to share its views on the current state of competition in those markets from the perspective of a wholesale purchaser.

Pricing

Following on from the Commission's declaration, MCT had a reasonable expectation that Telstra's prices for LCS would be calculated on an avoidable cost methodology at a discount to retail of between 17 and 25%. This has not been MCT's experience. MCT has not been able to achieve a price anywhere near this through negotiation. As a result MCT has lost money on the provision of local call services to its customers when MCT's own costs are taken into account. These matters are before the Commission awaiting arbitration.

Based on MCT's experience the critical factors of building a customer base and developing customer information have not been facilitated by the declaration to the extent that would have been envisaged at that time. Unlike some of its competitors MCT does not price local calls below the wholesale cost as a loss leader and prefers to let its customers exercise their own choices. A compounding factor, and further evidence of the early state of the declaration, is the fact that the Commission has yet to release the final pricing principles for LCS. It would seem difficult to make an assessment of the LTIE of de-declaration in the absence of these basic principles. Telstra's approach to pricing of LCS has meant that the associated benefits of the declaration for other markets have not developed fully. In the absence of this development, MCT would submit that it is way too premature to de-declare LCS even in CBD markets.

Nature of CBDs

There is a temptation to associate CBDs with large office blocks supporting sophisticated corporate clients who require a range of complex and state of the art telecommunications networks. The fact is that CBDs are diverse and contain a large number of very diverse types of services. There are many residential lines and small business services with relatively straightforward needs in large building complexes.

There are issues of building access for competitive suppliers and the practical restrictions placed upon new entrants for plant room space and access to cables and/or ducts. It would therefore be incorrect to characterise that most, if not all, CBD customers have a wide choice of alternative facility-based telecommunications providers. The expense associated with providing a direct-to-customer fibre service for small customers can render these customers uneconomic to access, especially when combined with the constraints of in-building cable capacity. In addition there are practical difficulties caused by interference to wireless systems, particularly to lower buildings. In fact for many customers the range of practical facilities access choices would be no greater than in a metropolitan area with a passing Optus HFC cable.

Competitive provision of LCS in CBDs

MCT has actively sought alternative suppliers to Telstra for the provision of LCS in all markets including in CBDs. The results have not been encouraging, in that where services are available they are restricted in some way (for example timed) or are so expensive that they do not provide a viable competitor to Telstra's prices. This is even the case in CBDs where MCT would expect that the absence of local call pre-selection would be less of a factor because of the wider availability of pre-dialing through PABX equipment. However while MCT does utilise this type of local call product the offerings are neither widely applicable nor economically compelling. This is most likely a symptom of the lack of maturity of competition, the difficulty of providing facility-based access for smaller customers and the difficulty encountered in breaking customer inertia. Indeed access to customer information, which is freely available to the incumbent, remains a major barrier to entry in the CDB as in other markets.

Delays in Providing LCS

MCT has been disappointed to suffer a long course of delays and frustrations in relation to obtaining access to the declared local carriage service. For many months after the declaration becoming effective Telstra did not offer to MCT any service in compliance with the local carriage service declaration. When such service was offered, the price at which it was offered did not differ significantly from the price offered prior to the declaration. Notwithstanding MCT's

commencement of an access arbitration in relation to this product and the publication of draft pricing principles in relation to the local carriage service by the Commission, Telstra has not ever given any indication of a willingness to negotiate or to offer a price for the local carriage service which is consistent with the application of an avoidable cost methodology to its retail price.

MCT notes that its position is far from unique and that at least 3 other parties have encountered similar difficulties in relation to obtaining access to the declared local carriage service and have commenced access arbitrations in relation to the supply of this service.

MCT therefore finds it astonishing that Telstra is now seeking the removal or restriction of this service declaration given that the declaration has either failed altogether to come into effect, largely as a result of a course of delays on the part of Telstra, or has come into effect only within the last couple of months. MCT believes that until such time as the declaration has been given the opportunity to meet the objectives outlined by the Commission at the time of the service declaration, Telstra's exemption requests should not be considered.

Wholesale Market

MCT submits that the only wholesale market for the supply of local carriage services is the one created by the declaration of local carriage service. That is, the supply of local carriage services is a natural Telstra monopoly which did not become a duopoly in the period 1991-1997 (the time of a regulated managed duopoly for wireline services), Telstra supplies local carriage services to itself and, as a result of the declaration, to other carriage service providers.

There are some, albeit insignificant, new entrants which supply local carriage service on a wholesale level. This supply is on the basis of a form of "tromboning" whereby the wholesale supplier acquires domestic PSTN originating access and domestic PSTN terminating access (both declared services) and links these two services in a gateway switched to create a local carriage service. As both PSTN terminating and originating access are timed services, this wholesale product is only attractive to sub-markets which have low average call hold durations. That is "tromboned" local carriage services are only viable in the non-residential, or business market where call hold times average 2.5 minutes.

Criteria for De-declaration

Facilities Access

Access to alternative facilities "on the street" in CBDs is not a sufficient condition to demonstrate alternative facilities access is a reality in the marketplace. Issues related to building access, cost of fibre lead-ins and interference to radio and microwave systems are real constraints to genuine facilities competition to a large segment of the customer base in CBDs. MCT has not had the time or resources to scope the extent of this, but would be pleased to assist the Commission or the TAF in any "facilities audit". These critical factors, that is a new "last corridor" rather than the traditional last mile, must be taken into account rather than a simplistic counting of alternative fibres in ducts.

MCT is of the view that the inquiry should be deferred until this audit and the competitive analysis is completed.

Customer Information & Inertia

This remains the greatest barrier and the one that declaration was designed to address. From MCT's point of view Telstra's approach to pricing and on going delays to obtaining an arbitrated price have thwarted the intent of the declaration so that it has not been fully effective. We consider that this regime needs to operate effectively for a reasonable period before this barrier can be dismissed. That period is yet to commence in CBDs or anywhere else.

Market Share

MCT agrees that market share in its own right is neither a sufficient nor necessary condition to measure the competitiveness of markets. If an incumbents market share has fallen to less than, say, 50% it provides reasonable proof that markets have opened up, but it does not indicate that easing of regulation is necessary. Continued access to regulatory relief, either actual or implied, may be necessary in order to retain competitors in the market.

Similarly, a higher market share does not show that competition is not present, as the incumbent may be a vigorous and successful competitor. Only extremes of market share provide a clear regulatory path and this is not the case in CBDs.

CBD

MCT does not consider that, in the context of this submission, the definition of CBD is relevant. However, for the purposes of economic analysis, MCT submits that the definition of CBD should encompass at least the following metrics:

- non-residential wirelines in services should exceed residential wirelines in service by a factor of 4:1;
- the average building height should be four storeys; and
- the definition should only apply in mainland state capital cities.

This would mean that term CBD could only be applied to the following areas of, for example, Sydney:

- City;
- North Sydney;
- Chatswood; and
- Parramatta

A reasonable approach would be to limit the definition to a certain percentage of lines served by specific local area switches. In Sydney, this might include Kent Street, a percentage of Haymarket, North Sydney, Chatswood and Parramatta but would exclude Paddington.

In Sydney, Pyrmont meets criteria (b) and (c) above but would not meet criteria (a). MCT does not accept that the total number of wirelines would even approach the 600,000 suggested by Telstra and accepted by the Commission in its rejection of the revised Telstra PSTN undertaking.

Conclusion

MCT welcomes the Commission's action in initiating this review and agrees with the principle of winding back unnecessary regulation wherever possible. MCT would however contend that the mere presence of fibre loops and some wireless alternative access regimes in CBDs are not sufficient evidence to show that regulation is not required. In MCT's view the barriers to entry in relation to customer information and the ability to economically offer full service are still as real as they were in June 1999.

Therefore this review should be deferred until a number of key milestones are achieved:

- A full facilities audit and related competitive access analysis,
- Completion and finalisation of the LCS pricing principles and
- Resolution of the outstanding LCS pricing disputes

MCT would welcome the opportunity to assist the Commission in that inquiry and would also be pleased to be part of any industry approach to investigate and resolve these issues.