



**CABLE & WIRELESS
OPTUS**

**Cable & Wireless Optus’
Submission to the ACCC
on the Future Scope of the Local Carriage
Services Declaration**

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1. Executive Summary

- 1.1 This submission is written in response to the Commission's discussion paper on the Future Scope of the Local Carriage Services Declaration. Telstra has sought an exemption from having to provide a regulated local carriage service. The main points that this submission makes are outlined below.
- 1.2 The Commission should not grant Telstra an exemption from having to provide the local carriage service in CBD or other areas. The local carriage service is crucial for competition in numerous markets. Telstra holds significant market power in the local call market. It has 95 per cent of the residential access market and over 81 per cent of the local call voice business market. Granting Telstra the requested exemption would not advance the long-term interests of end users (LTIE).
- 1.3 The Commission should grant a class exemption to all carriers offering local carriage services that do not have a substantial degree of market power. The current inclusion of new entrants' networks (without substantial market power) in the declaration does not advance the LTIE. It is unnecessary (as competitors have access to the incumbent's service), reduces incentives to invest, means new entrants' networks are potentially more heavily regulated than the incumbent's, undermines facilities based competition and reduces consumer welfare.
- 1.4 At present there is no viable alternative to the wholesale supply of local carriage services. Wholesale services that are currently being rolled out using the unconditioned local loop service (ULLS) are targeted at supplying data services rather than telephony. Further, ULLS is not actually being supplied by competitors to end users on a competitive basis. In addition to this, the prices that Telstra is proposing to charge for ULLS are anti-competitive, make the supply of voice services using ULLS uneconomic, and will not allow competitors to compete against Telstra. There are also a variety of non-price impediments to competitors competing against the incumbent.
- 1.5 The Commission should take this opportunity to redraft the service description for the local carriage service. The current service description represents a 'bare bones' approach and does not cover all the elements of the local carriage service. For instance, it does not cover line rental or access to operational support systems. Since the declaration, Telstra has used the non-inclusion of these elements in the service description to undermine competition. Cable & Wireless Optus notes that the ACCC has recommended to the Productivity Commission that the statutory access obligations should include an obligation to provide equivalent operational support systems. We support this recommendation however, in the meantime, the Commission should amend the services description to include these elements.

- 1.6 Cable & Wireless Optus suggests that at some time in the future the Commission may be able to remove the declaration of the local carriage service on the incumbent's network. This should be linked to specific competition tests that demonstrate Telstra no longer retains significant market power in the local loop, and that local telecommunications is effectively competitive. The Commission could, in this inquiry, indicate the criteria under which it may undeclare Telstra's local carriage service. We provide details on the indicia – using standard anti-trust analysis – that would indicate when the market is effectively competitive.
- 1.7 The approach proposed by Cable & Wireless Optus is consistent with approaches in overseas jurisdictions – where ex-ante regulatory measures target operators with a substantial degree of market power rather than new entrants. For instance, the draft recommendations of the European Review recommend that ex-ante regulation should only be imposed on entities with significant market power. Significant market power is generally held to exist in European jurisprudence where an entity has 50% of the market.

2. Introduction

- 2.1 Telstra has lodged an application for an exemption under s.152AT of the *Trade Practices Act 1974* (the Act) from its obligation to provide local carriage services to its competitors in the CBD areas of Melbourne, Sydney, Brisbane, Adelaide and Perth. Telstra has stated in its exemption application that its long-term objective is to obtain an exemption from having to supply local carriage services to its competitors throughout Australia.
- 2.2 The Commission is also considering whether or not it should grant a class exemption intended to exempt all current and future carriers supplying the local carriage service in CBD areas of Melbourne, Sydney, Brisbane, Adelaide and Perth from the standard access obligations.
- 2.3 We do not believe that the Commission should grant Telstra an exemption from having to provide local carriage services. It still holds significant market power in the local call market. The Commission should however grant new entrants without significant market power a class exemption from the declaration.
- 2.4 This submission proceeds as follows: it outlines the statutory criteria the Commission must use when undeclaring a service; the reasons that Telstra's service should not be excluded from the declaration; and the reasons that new entrants networks without significant market power should be excluded.

3. Statutory criteria

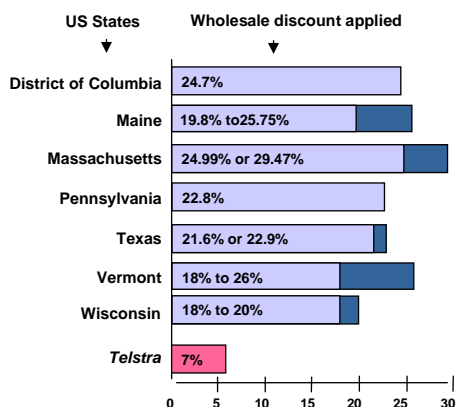
- 3.1 In determining whether to grant an individual exemption to Telstra and a class exemption to other carriers in relation to the local carriage service under s.152AT of the Act, the Commission must determine whether granting such exemptions would advance the long term interests of end users (LTIE).

- 3.2 The criteria to determine whether a particular thing will advance the long-term interests of end-users is found at s.152 AB of the Act. The long term interests of end users is to be assessed with reference to the following objectives:
- (a) Promoting competition in markets for listed services;
 - (b) Achieving any to any connectivity in relation to carriage services that involve communications between end users; and
 - (c) Encouraging the economically efficient use of, and the economically efficient investment in the infrastructure by which carriage services are supplied.
- 3.3 It is in the long-term interest of end users for the Commission to link the obligation to supply local carriage services to the possession of substantial market power. To achieve this, the ACCC should grant a class exemption which would only apply to those carriers that do not possess substantial market power in the local carriage services market. Objective criteria could be laid down to clearly measure whether or not a certain carrier has substantial market power in the local carriage services market.
- 3.4 By granting a class exemption which is linked to market power, the Commission would be promoting competition by ensuring that local carriages services continue to be competitively supplied in areas where there is not sufficient facilities-based competition. The Commission would be promoting local facilities based competition from alternative sources of supply to Telstra. And the Commission would also be encouraging efficient use of and investment in infrastructure as new entrants would automatically fall within the exemption and the incumbent would also fall within the exemption when sufficient competition existed.

4. Overview of why the Commission should not grant Telstra an exemption

- 4.1 The Commission should not grant Telstra the requested exemption in relation to local carriage services for the reasons outlined below.
- 4.2 It is incumbent on Telstra to prove why granting the exemption would promote competition and would encourage efficient investment in infrastructure. Telstra's arguments on this issue should be exposed for public comment.
- 4.3 Cable & Wireless Optus believes that granting Telstra the requested exemption would not promote competition as most local call competition has come from local call resale. Telstra still holds significant market power in both the local access market and the local call retail market. For instance, it has 95 per cent of the access market and over 81 per cent of the local voice business customer segment of the market. Further, if does not provide the local call service on anywhere close to the same terms as this service is provided in the United States. The following table compares the commercial discounts offered by Telstra with standard resale discounts offered in the United States:

Example 1 - Telstra's commercial discount offer for LCS compared to US carriers



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- 4.4 The lack of a proper avoidable cost discount makes it very difficult for new entrants to compete with Telstra via the local call resale service. If this service was undeclared the Commission would not be able to set the terms and conditions, a reasonable wholesale/retail margin, that will allow new entrants to compete.
- 4.5 As was established in the Commission's original declaration, local call resale is a legitimate means of introducing competition to the market. The importance of local call resale for competition is recognised by numerous precedent and expert opinions. Indeed, Telstra's own submission to the recent New Zealand telecommunications regulatory review recognises the importance of local call resale. Telstra recommended in the New Zealand inquiry that the equivalent of Australia's declaration/arbitration regime be applied to the resale of Telecom New Zealand's local services.
- 4.6 Local call resale allows competitors to offer a full service, build up a customers base and provides a 'stepping stone' to full facilities based competition. It advances competition and investment.
- 4.7 There are still significant anti-competitive structural factors that are limiting the development of partial and full facilities-based competition. For instance, competitors are currently unable to effectively port the numbers of business customers because Telstra has effectively refused to provide business local number portability. We have provided Telstra with a list of over 30 CBD businesses that we wish to port, and as of yet, Telstra has not ported one of these

business customers. In addition, Telstra's processes are slow, cumbersome and inefficient. Absent business number portability, significant facilities based competition is will not take hold in CBD areas because businesses will not take telephony services from alternative carriers, even with high savings on prices offered, where it involves the businesses changing their telephone numbers.

- 4.8 In addition, the rollout of ULLS is being undermined by the prices that Telstra is seeking to charge as well as the non-price requirements it is imposing.
- 4.9 Alternative access mechanisms, which may sometime in the future offer an alternative to the Telstra network, are not close to being viable. Telstra has argued in the past, for instance, that services provided over LMDS spectrum could offer an alternative to its local loop. This service is yet to be commercially deployed anywhere. Indeed the Government has yet to auction LMDS spectrum for carriers other than AAPT. In fact, none of the potential alternative access technologies have developed in any significant manner since the Commission previously examined declaring the local carriage service.
- 4.10 If Telstra receives its requested exemption, facilities-based or partial facilities-based competition will be the only substitute for Telstra local calls. In those areas not covered by new entrant infrastructure, there will only be one local call product available, resulting in reduced levels of competition.
- 4.11 Competition in the long-distance market would also be reduced if the Commission granted Telstra the exemption. For those customers connected only to Telstra, demand for one bill means that local call resale is necessary to obtain these customers' long-distance call business. The conditions for competition in the long-distance retail market will not be promoted by the exemption because Telstra would withdraw its local call resale service and customers would return to multiple bills unless they directly connected to a competing local call provider.
- 4.12 The Commission should take this opportunity to change the local carriage service description to take into account line rental and access to operational support systems. These elements are part of the local carriage service. Telstra has used their non-declaration to price, and provide access, in a manner that is anti-competitive. Cable & Wireless attaches a proposed service description (Attachment 1).
- 4.13 The Commission may be able to undeclare Telstra's local call service at some point in the future when the market is fully competitive. We believe that the Commission should provide some indicia which it would consider demonstrated that this market was competitive. Given that Telstra apparently wants this service undeclared, the outlining of such indicia would provide Telstra with a benchmark, and incentive, which it could aim for to ensure the undeclaration of the service. This section provides some suggested indicia.

5. Importance of Access to Local Carriage Services

- 5.1 There are three paths to increased competition in the local call market:
- Resale of local carriage services;
 - Partial facilities-based competition; and
 - Infrastructure-based competition.
- 5.2 As identified by the ACCC, declaration of local carriage services has the potential to lower the barriers to entry so that local call resale can be used as a 'stepping stone' to reduce the risks associated with roll out of a customer access network. In this way, the wholesale supply of local carriage services increases competition in the local call market by enabling end-users to enjoy the benefits of competition sooner than would be the case with competition based on the roll out of alternative infrastructure.
- 5.3 The Draft Report of the Ministerial Telecommunications Inquiry currently being conducted in New Zealand recognised the importance of local call resale. The Inquiry's Draft Report contained a proposal to designate the wholesale supply of New Zealand Telecom's local loop. In particular it stated:

“Telecom’s local loop continues to be the primary telecommunications service for the large majority of users. While the provision of telecommunications services is increasingly being tailored to meet individual users’ needs, and wireless telephony is growing in importance, the Inquiry’s view is that the fixed telephony service will remain an essential telecommunications service for the large majority of users for some time. Given this ongoing importance, the Inquiry’s view is that it is desirable that competitive pressures continue to bear on the fixed telephony service.....At present, Telecom is the only provider of a ubiquitous fixed network. Except for Wellington residents, who have the option of using Saturn’s network, residential customers in New Zealand rely on Telecom for their fixed telephony service. Although in a number of business districts there is competing infrastructure for business users, in smaller centres Telecom is the single provider of a fixed telephony service. Mandatory wholesaling of Telecom’s local loop would allow consumers to choose the company they wish to deal with for their electronic communications needs. While local loop competition is emerging, the Inquiry’s view is that, given the importance of the fixed line service for most customers, and the absence of any competition for

provision of this service in many areas, wholesaling Telecom's local loop – in residential and commercial areas alike – should be mandated.”

- 5.4 In its submission to the New Zealand Ministerial Telecommunications Inquiry, Telstra also acknowledged the benefits of resale entry as a stepping-stone to full facilities-based competition. Telstra supported mandation of local call resale with back-stop government dispute resolutions procedures in the event reasonable terms and condition could not be negotiated with the incumbent carrier:

“It is acknowledged that resale competition is both a useful phase in the move towards facilities based competition and can also be a legitimate means of competition in itself. Resale can be a value adding enterprise if the reseller is able to bring added efficiencies and add on services. As such, the facilitation of resale of some basic services should be encouraged, and some form of dispute resolution process provided for. This should allow for more efficient “build-buy” decisions to be made.”¹

- 5.5 As discussed by Professors Baumol, Willig and Ordober:

“Passage of the 1996 Telecommunications Act offers an invaluable opportunity to extend the benefits of competition to users of every product and segment of the industry, especially the local exchange, where competition has been least extensive and effective. Availability of unbundled network elements for sale at prices based on economic costs will foster efficient and prompt competition at all levels — from resale alone at one end of the spectrum, to full facilities-based at the other, and through the broad middle range of partially-facilities based competition. All of these forms of competition can benefit end users, bringing new vitality, innovation, pressures for cost-efficiency, and superior customer service to the market. But the fundamental policy of the 1996 Act — extending all form of competition to the markets where it is now absent — cannot be attained unless the pricing principles here are carried out. Misguided allegiance to prior regulatory norms or departure from the

¹ Telstra submission to the NZ inquiry at 15.

logic of free and competitive markets would frustrate the central goals of the Act. ...Where, as here, markets are ineffectively competitive and regulatory oversight is warranted, regulators should set prices that replicate as closely as possible, the prices that would prevail in competitive markets.”

5.6 As discussed by the US Federal Communications Commission in its First Report and Order:

“The Act contemplates three paths of entry into the local market -- the construction of new networks, the use of unbundled elements of the incumbent's network, and resale. The 1996 Act requires us to implement rules that eliminate statutory and regulatory barriers and remove economic impediments to each. We anticipate that some new entrants will follow multiple paths of entry as market conditions and access to capital permit. Some may enter by relying at first entirely on resale of the incumbent's services and then gradually deploying their own facilities. This strategy was employed successfully by MCI and Sprint in the interexchange market during the 1970's and 1980's. Others may use a combination of entry strategies simultaneously -- whether in the same geographic market or in different ones. Some competitors may use unbundled network elements in combination with their own facilities to serve densely populated sections of an incumbent LEC's service territory, while using resold services to reach customers in less densely populated areas. Still other new entrants may pursue a single entry strategy that does not vary by geographic region or over time. Section 251 neither explicitly nor implicitly expresses a preference for one particular entry strategy. Moreover, given the likelihood that entrants will combine or alter entry strategies over time, an attempt to indicate such a preference in our section 251 rules may have unintended and undesirable results. Rather, our obligation in this proceeding is to establish rules that will ensure that all pro-competitive entry strategies may be explored. As to success or failure, we look to the market, not to regulation, for the answer.....Congress recognized that, because of the incumbent LEC's incentives and superior bargaining power, its negotiations with new entrants over the terms of such agreements would

be quite different from typical commercial negotiations. As distinct from bilateral commercial negotiation, the new entrant comes to the table with little or nothing the incumbent LEC needs or wants. The statute addresses this problem by creating an arbitration proceeding in which the new entrant may assert certain rights, including that the incumbent's prices for unbundled network elements must be "just, reasonable and nondiscriminatory."² We adopt rules herein to implement these requirements of section 251(c)(3)."

- 5.7 Cable & Wireless Optus believes that, for the reasons outlined below, access to Telstra's local carriage services is essential in areas where there is insufficient facilities-based competition and Telstra has substantial market power.

6. Limited competing infrastructure

- 6.1 Cable & Wireless Optus uses local call resale as a necessary tool in gaining customers who want bundled services where those customers are not directly connected to the Cable & Wireless Optus network. Without local call resale, Cable & Wireless Optus would be unable to offer bundled services to these customers until such time as we have rolled out infrastructure directly to that customer.
- 6.2 Cable & Wireless Optus' HFC network passes 2.3 million homes and has approximately 390,000 directly connected residential customers. Telstra on the other hand has nearly 7 million directly connected residential customers.
- 6.3 Cable & Wireless Optus' BNS network is located in all capital cities except Darwin. The Cable & Wireless Optus BNS network is directly connected to approximately 676 buildings in CBD areas of these capital cities. Telstra, on the other hand, has approximately 2,830,000 basic business access lines in service.
- 6.4 Cable & Wireless Optus remains reliant on Telstra for access to local carriage services in those areas where we have no network coverage or for buildings not yet directly connected to the Cable & Wireless Optus network.
- 6.5 Smaller CSPs are even more reliant on Telstra for access to local carriage services in order to supply local calls to consumers. The number of arbitrations currently underway against Telstra provide further evidence of the importance to CSPs of the wholesale supply of local carriage services. These arbitrations are yet to be resolved and the ACCC is yet to make a final determination in respect of these arbitrations.

² See 47 U.S.C. § 251(c)(3)

- 6.6 Another reason for CSPs being heavily reliant on Telstra's local carriage services is that alternative local call access mechanisms such as the unbundled local loop and local multipoint distribution system (LMDS) are yet to become viable alternatives to the wholesale supply of local carriage services.
- 6.7 Although the ACCC declaration of the unconditioned local loop (ULL) took effect on 4 August 1999, access to the ULL service is proving difficult and will take some time to fully develop into a viable alternative to wholesale supply of local carriage services.
- 6.8 XYZed Pty Ltd, a fully owned subsidiary of Cable & Wireless Optus, was formed to independently build and maintain a national digital subscriber line (DSL) network and to deliver a wholesale DSL service using Telstra's ULL. On 4 September 2000, XYZed launched its commercial service, which is a wholesale DSL service to be used for high-speed broadband applications. The service will initially be available at around 50 exchanges and more than 100 exchanges will be available nationwide by early 2001. It is planned that, at the completion of the proposed network roll out, XYZed's services will be accessible by more than 75 per cent of Australian businesses.
- 6.9 It should be noted however that the DSL services supplied by XYZed are for use in the supply of high-speed data services as opposed to voice services.
- 6.10 AAPT has also requested access to 70 exchanges from Telstra for DSL however it is unclear if Telstra has yet provided access to those exchanges. AAPT has expressed its business plans for a residential DSL offering using Telstra's ULL. However, according to AAPT, this proposition is not viable at the prices currently proposed by Telstra.
- 6.11 Unless Telstra and/or AAPT offers a wholesale DSL voice service, the ULL will not replace the need for wholesale supply of local carriage services in the short-term.
- 6.12 It should also be noted that Telstra is in arbitration over its proposed prices, terms and conditions for access to the ULL. Until more reasonable prices, terms and conditions are set by the ACCC, the take-up of the ULL service may be slow and be unlikely to replace the need for wholesale supply of local carriage services.
- 6.13 In relation to LMDS, only AAPT has LMDS spectrum and has so far failed to roll out its LMDS network. According to AAPT, delays in rolling out its network have been caused by the existing vendor not being able to supply appropriate point to multipoint equipment. AAPT is currently trialing another vendor's point to multipoint equipment. AAPT has indicated that, if the trials are successful, AAPT will then commence rolling out the equipment within 60-90 days. However, it is unclear when AAPT's LMDS network will be fully operational and exactly what services will be run over that network.
- 6.14 More LMDS spectrum is yet to be auctioned and the outcome of this auction cannot be predicted. Depending on the competition rules adopted for the

auction, Telstra may obtain LMDS spectrum and be in a position to roll out competing infrastructure in a way which frustrates new entrants (similar to its rollout of HFC network). If LMDS spectrum is obtained by other CSPs, the impact on competition will be delayed until appropriate equipment can be obtained, the network is rolled out and customers are connected to that network.

- 6.15 Based on the above, LMDS cannot currently be considered a viable alternative to the wholesale supply of local carriage services.

7. Telstra still holds significant market power

- 7.1 Overall, Telstra is estimated to have approximately 81.3% market share of the local voice business customer segment of the market.³
- 7.2 When comparing revenue, Telstra's estimated earnings from local calls and access in 2000 will be approximately \$4.6 billion whereas Cable & Wireless Optus' forecast revenue for 2000 from local calls and access will be approximately \$1.5 million.⁴
- 7.3 According to research undertaken by Paul Budde Communications, there are approximately 10 million main telephone lines in Australia with only 10 per cent penetration of second lines - a 3 per cent increase from 7 per cent in 1997.⁵

8. Structural impediments to competition in CBD areas

- 8.1 Telstra's effective refusal to port medium to large business customers has also exacerbated Cable & Wireless Optus' reliance on wholesale local carriage services from Telstra in CBD areas. Even after Cable & Wireless Optus directly connects a business customer, Telstra has indicated that, because of network congestion, it will take up to 10 months to port that customer. Telstra has indicated that it will decide how long it will take to port on a case by case basis however it has refused to upgrade its network capacity proactively to allow porting to proceed in a more timely manner.
- 8.2 As a result, Cable & Wireless Optus must continue to use Telstra tails for the provision of services to that customer until the port can proceed. Telstra's refusal to provide LNP to business customers in a timely manner has greatly impacted on Cable & Wireless Optus' ability to win large business customers in CBD areas and increase our share of that market.
- 8.3 In relation to the ULL service, as stated above, XYZed's wholesale DSL service is primarily aimed at providing high-speed data services to business customers.

³ See p.41, Telecommunications Strategies In Australia 1999/2000, Paul Budde Communication

⁴ See p.64, Telecommunications Strategies In Australia 1999/2000, Paul Budde Communication

⁵ See p.7, Telecommunications Strategies In Australia 1999/2000, Paul Budde Communication

XYZed is not proposing to offer a stand-alone voice service and therefore does not at this stage offer a substitute to local call resale.

- 8.4 Even if AAPT or another new entrant were to offer a voice service using Telstra's ULL service, Telstra's regulatory gaming in relation to ULL may result in a delayed rollout of any voice services using Telstra's ULL service. Telstra has not accepted that the declared service is the same unbundled copper on which it provides nearly all of its services to date. As a result, Telstra is seeking to provide access seekers with a service which is different to the one which it provides to itself. This will result in different systems and processes being provided to access seekers with outcomes that are inherently discriminatory and anti-competitive.

9. Commission should refine current declaration

- 9.1 The Commission should use its current inquiry to change the service description for the local carriage service to include the line rental component and operational support services
- 9.2 In the Commission's original inquiry into declaring the local carriage service, Cable & Wireless Optus argued that the service description should include line rental and operation support services as being integral elements in the local carriage service.
- 9.3 In relation to line rental, we were concerned that the Commission's bare bones service description would mean that Testra could recover any short fall in revenues derived from the local call service (following an arbitration) by increasing its line rental charges.
- 9.4 In relation to operational support services, we were similarly concerned that a bare bones service description would enable Telstra to continue its discriminatory conduct in respect of pricing and service levels and so ensure that the product offered by carriage service providers was inferior to that offered by Telstra.
- 9.5** Telstra's pricing behaviour for the local carriage service since the declaration of this service has indicated that it is indeed exploiting the limited nature of the local carriage services declaration to the detriment of competition and consumers. Telstra continues to supply line rental to Cable & Wireless Optus on retail rather than wholesale terms and similarly provides less favourable operational support systems to Cable & Wireless Optus than it does to itself.

10. Class Exemption should be linked to market power

- 10.1 The current inclusion of new entrants' networks in the service description does not advance the LTIE. As such, Cable & Wireless Optus believes that the ACCC should grant a carrier-neutral class exemption to all carriers offering local carriage services that do not have substantial market power.
- 10.2 Such a class exemption would allow the current declaration to apply to those carriers with substantial market power whilst, at the same time, enabling new entrants to fall outside the scope of the declaration unless and until they possess substantial market power. The incumbent would be required to supply local carriage services until it ceased to possess substantial market power.
- 10.3 Cable & Wireless Optus believes that the current local carriage services market can not be viewed as being competitive until all of the following indicia are met:
- Each carrier has less than 50 per cent market share of the retail local call market;
 - No carriers possesses greater than 50 % of direct connections in the geographic area;
 - At least 75% of customers have choice over their local fixed network provider;
 - Wholesale local carriage services are being supplied at prices consistent with an avoidable cost methodology;
 - Resale carriers have access to effective operations and support systems of the underlying network carrier that previously possessed significant market power in local telephony services; and
 - Unbundled local loop is available at efficient cost based prices, and Telstra possesses less than 50 % market share at the retail level of ULLs services;
 - Local number portability is being offered by all carriers in a timely and effective manner, under conditions where each carrier bears their own costs.

11. Overview of why the ACCC should grant a class exemption

- 11.1 Cable & Wireless Optus believes that the Commission should grant a class exemption to apply to those carriers without substantial market power for the following reasons:
- The ACCC's original declaration focussed entirely on Telstra's network when outlining the reasons why the declaration advanced the long-term interests of end-users. The Commission's failure to carry out an LTIE analysis in relation to the declaration of new entrant networks demonstrates that such networks were not justifiably included in the original service description;

- Declaration of new entrants' networks does not advance the LTIE because end-users already have additional choices flowing from the declaration of Telstra's network, declaration increases new entrant's costs, acts as a disincentive to further investment and undermines facilities-based competition;
- Part XIC of the Act was enacted primarily to enable access to bottleneck telecommunications facilities. New entrant telecommunications networks could not be considered to be bottleneck facilities;
- Recent reviews of regulation of electronic communications markets in developed countries (EU, New Zealand, UK and Ireland) provide consistent evidence for the proposition that access regulation should be targeted at significant market power to limit regulatory intervention to where it is required, to avoid disincentives for investment, and to reduce the ongoing costs of regulation.

11.2 These points are discussed in further detail below.

12. Commission has not conducted an LTIE analysis

- 12.1 In the Commission's declaration of local carriage services in July 1999 it did not conduct an analysis of whether the declaration of new entrant networks would advance the long-term interests of end-users. All of the Commission's analysis focused on Telstra's network. The entire discussion in section 4 of the Commission's declaration decision focuses on Telstra (see for example pages 45-47). In fact, the Commission reasons that Telstra has substantial market power because it has between 98-99 per cent of the market (see for example point 5.1.1).
- 12.2 It is clear from the Commission's discussion that it is implicitly assumed that Cable & Wireless Optus and other new entrants do not have market power. At the time of declaration Cable & Wireless Optus had only one per cent of the direct connections into Australian homes. While we have been growing market share since July 1999, we currently only have 5 per cent of connections into homes. There is no jurisdiction in the world where such a market share would be considered to constitute significant market power.
- 12.3 In its decision of July 1999 the Commission was clearly aware that it had not conducted a long term interests analysis on networks other than Telstra. It was explicit at this time that, 'in addition to its preference for service descriptions that are technologically neutral, the Commission prefers that the description not specify the identity of the access provider'. The Commission further said:

"In the Commission's view this approach best reflects the intent of the legislation which has included a special process for exempting particular access providers from the statutory consequences of

declaration - s. 152AT of the Act - and also for exempting a class of access providers - s. 152AS of the Act.....Under s. 152AT an access provider can apply to the Commission for an exemption from the standard access obligations. The Commission can grant an exemption where it is satisfied that to do so would promote the long-term interests of end-users of carriage services or of services provided by means of carriage services. The same test is applicable for class exemptions under s. 152AS.”

13. Access obligations should be linked to market power

- 13.1 Cable & Wireless Optus believes that Part XIC is intended to primarily target access providers with market power derived, in particular, from control over a bottleneck or essential facility. This was clearly the approach that the Commission took when it declared the local carriage service. Much of the analysis of the paper focuses on Telstra’s bottleneck control of the customer access network.
- 13.2 The Report by the Independent Committee of Inquiry on National Competition Policy (more commonly known as the Hilmer Report), which was instrumental in bringing about the access provisions in the Act, strongly argued that access regulation should only apply to essential facilities. In its Report, the Committee stated that a facility should only be declared where:

“I. Access to the facility in question is essential to permit effective competition in a downstream or upstream activity;

Clearly, access to the facility should be essential, rather than merely convenient.

II. The making of the declaration is in the public interest, having regard to: (a) the significance of the industry to the national economy; and (b) the expected impact of effective competition in that industry on national competitiveness”⁶.

⁶ See p. 251, National Competition Policy, Report by the Independent Committee of Inquiry, August 1993

13.3 New entrant telecommunications networks, including Cable & Wireless Optus' networks, would not meet the above criteria because these networks are not essential for effective competition in any upstream or downstream markets. Access to Telstra's ubiquitous network for local carriage services has provided CSPs with an ability enter the local call market and offer local calls to consumers in any area in Australia.

13.4 It is important in considering whether services should be subject to regulated access to bear in mind the correct economic definition of a bottleneck or essential facility. Jerry Hausman, Professor of Economics at MIT, has provided the following definition:

“A bottleneck facility, also referred to a monopoly building block services or an essential facility, has the following economic characteristics: (1) a competitor requires their use to provide a given service so that they provide an essential function (2) they cannot be purchased by the competitor from another supplier at a reasonable economic cost (3) the functions cannot be supplied in an alternative manner at a reasonable economic cost“.

13.5 From this economically correct description of a bottleneck, Cable & Wireless Optus and other new entrants cannot control a bottleneck facility because characteristic (2) is not present – the service can always be purchased from Telstra at economic cost⁷. A new entrant such as Cable & Wireless Optus cannot control an essential facility unless it develops a building block service that is essential to competition.

13.6 While the terms of Telstra's supply of local call services are currently unreasonable it is quite clear that service providers are able to purchase from an alternative supplier. To our knowledge One.Tel, AAPT, Macquarie and RSL Com are all purchasing local call resale from Telstra and providing services to end users.

13.7 Indeed, Professor Hausman has stated that:

“No economic reason exists to regulate access for new entrants. Consumers always have the ability to purchase service from the incumbent provider, Telstra. Indeed no regulatory agency in any country has regulated the access prices of new entrants. Net entrants cannot have bottleneck pricing power because of the services offered by

⁷ This assumes that the ACCC will apply the avoidable cost methodology in setting economic cost prices.

the incumbent carrier. Regulation imposes significant costs and will lead to decreased investment by new entrants and decreased competition. Thus, price regulation of services by new entrants is a mistake that will decrease competition and harm consumers.”

- 13.8 The declaration of local call services on new entrant networks, including Cable & Wireless Optus’ network, does not advance the first limb of the LTIE – competition – because:
- (a) Providing local call resale on those networks is not necessary to promote resale as competitors can use Telstra’s network;
 - (b) End users already have additional choices of service provider because of the declaration of Telstra’s network
 - (c) The declaration increases new entrants’ costs, will act as a disincentive to further investment and undermines facilities based competition
 - (d) The avoidable cost pricing methodology when applied to new entrant networks will act as a disincentive to us reducing our prices.
- 13.9 Whether a declaration will promote competition should be viewed in the context of the three major ways of facilitating competition in local services market. The three ways of introducing such services are outlined by the FCC:

“The US Telecommunications Act 1996 contemplates three paths to entry into the local market – the construction of new networks, the use of unbundled elements of the incumbents network and resale. The 1996 Act requires us to implement rules that eliminate statutory and regulatory barriers and remove economic impediments to each. We anticipate that some new entrants will follow multiple –paths of entry as market conditions and access to capital permit. Some may enter by relying at first entirely on resale of the incumbent’s services and then gradually deploying their own facilities. This strategy was employed successfully by MCI and Sprint in the inter-exchange market during the 1970s and 1980s. Others may use a combination of entry strategies which their own facilities to serve densely populated sections of the incumbent service territory while using resold services to reach customers in less densely populated areas. Still others may pursue a single entry strategy.”

13.10 The FCC clearly recognises that the job of regulators is not to pick which is the best method of introducing competition into the local loop – unbundled elements, facilities based competition or resale. The job of the regulator is to ensure that competitors have access to incumbent’s facilities at reasonable economic cost so that they can make build/buy decisions. The market should then be allowed to determine which entry strategy competitors follow.

13.11 The declaration of the new entrant networks is not a necessary building block to advance competition in down stream markets in the way that Telstra’s network is. As is pointed out in the Commission’s own paper on declaring the local call service:

*“Telstra is the major supplier of local telephony services with a market share of around 94 percent”.*⁸

13.12 The Commission goes on to say that:

*“the ability of service providers to compete effectively in the local telephony market through re-supplying local telephony services is largely influenced by the terms and conditions on which local carriage services are supplied to them. The charges paid to Telstra represent approximately 90-100 per cent of the revenue received by service providers from their customers for those services”.*⁹

13.13 This clearly demonstrates that it is Telstra’s ubiquitously deployed CAN that is the essential facility or ‘building block’ for service providers to compete in the local telephony market. New entrant networks are not a necessary input for such competition.

13.14 The relative unimportance of new entrant networks in facilitating resale competition is borne out by the fact that, while there is local call resale competition, this is all carried out over Telstra’s network.

14. Declaration of new entrant networks is not required to increase user choice

14.1 The Commission said that a significant reason for declaring the local call service was to provide end-users with a choice of service provider. It said:

⁸ See p.102

⁹ See p.102

“Declaration is not expected to increase the penetration of telephony services. It can however provide end users with additional choices in terms of service provider, increased competition on the retail service dimensions and depending on the service provider’s costs lead to lower priced local calls for end users”.

14.2 While there are significant problems with the terms of supply of Telstra’s local call service (in particular the wholesale price does not yet reflect the proper application of an avoidable cost methodology), it is clear that the declaration of the local call service has provided additional choice of services. Carriers have clearly been able to enter the market, partly on the assumption that the Commission will eventually properly apply an avoidable cost methodology to Telstra, to deliver a plethora of new services to end users. This additional choice of services has been provided *without* new entrants providing a wholesale local call service offering to other carriers.

14.3 Pricing plans using Telstra’s wholesale service include the following:

Company	Call Price	Line Rental	Conditions (additional charges)
Optus	20 cents	\$12.80 (per month) Covers line rental, network maintenance, faults and service difficulties and directory assistance enquiries.	Service Establishment Fee - \$77.00 Service Activation Fee - \$55.00 Extra Sockets: Your second socket - \$82.50 Each additional socket - \$33.00
AAPT	16.5 cents	Residential line rental –\$16.5 per month Business line rental - \$30 per month.	All other charges are at Telstra's standard rates. Available to Full Service customers only who are preselected to AAPT for long distance. Available to residential & businesses up to 4 lines only.
One.Tel	17.5 cents	Standard Telstra Line rental continues to apply	The Services are only available only to residential or small business customers. Small business means a business with 4 or less lines or phone numbers.

Dingo Blue	19 cents	Residential - \$12.75 (per month) Business - \$22.50 (per month)	Customers must remain preselected to Ding Blue for their LD services.
Macquarie	Varies according to customer*	Varies according to customer.	Not available. * (Local call prices range from approx 8%-20% discount off standard Telstra local call rate.)

15. Declaration undermines investment and facilities-based competition

15.1 Facilities-based competition is a highly effective, where the economic characteristics of the market permit, to bring effective sustainable competition to the local loop. However, the Commission's current inclusion of new entrant services in its local call service declaration undermines facilities based competition because:

- (a) The barriers to entry into the local loop are already high;
- (b) The declaration could dramatically increase new entrant costs; and
- (c) It increases new entrants' risk profile which is already greater than the incumbent's

15.2 The net effect of the declaration of new entrants networks is that it will reduce incentives to invest and not promote long term competition.

16. Barriers to entry already high

16.1 The barriers to entry to the local loop are already high as telecommunications is characterised by incumbents with significant market share high sunk costs and a high proportion of fixed and common costs.

16.2 Ovum in its Local Loop Competition Report describes these high barriers to entry as follows:

“The local loop has a high capital cost with a relatively small cost per additional subscriber. The unit cost for a competitor with ten per cent market share is three or four times that of the dominant player. As a result the economies of scale create a very high cost barrier to market entry”.

- 16.3 The Commission should not be involved in a declaration which increases the risks (which arise from the economics of telecommunications and teledensity) of competing with an incumbent in the local loop to a higher level than they are already set by virtue of the characteristics of the local loop. Such investment should be encouraged as an efficient way of introducing competition.

17. Increased barriers to entry by increasing costs

- 17.1 The declaration currently exposes new entrants to a large increase in costs to provide a service that is not necessary to promote competition. This increase in our costs raises the barriers to entry in a market that it already very difficult to enter because of the economics of telecommunications.
- 17.2 It may appear paradoxical that a new entrant, with a lower cost base and newer technology has a higher cost base than the incumbent. This fact arises, however, because of the economics of telecommunications. Telecommunications is characterised by a high degree of fixed and common costs. This means that the per unit cost of providing a services is driven – to a very large extent – by the volume of calls that run across the network. This is recognised internationally.
- 17.3 For example, the FCC has said that:

“An incumbent Local Exchange Carrier’s (LEC) existing infrastructure enables it to serve new customers at a much lower incremental cost than a facilities based entrant that must install its own switcher, trunking and loops to service its customers... Because an incumbent LEC currently serves virtually all subscribers in its local servicing area, an incumbent LEC has little economic incentive to assist new entrants in their efforts to secure a greater market share... the incumbent LEC’s have economics of density, connectivity scale: traditionally they have been viewed as creating a natural monopoly”.¹⁰

- 17.4 The Commission’s own modeling of Telstra’s PSTN network supports the notion that there are natural monopoly characteristics to the local loop. The NERA model, which was commissioned by the Commission as part of its assessment of Telstra’s PSTN undertaking, finds that 47% of the costs of constructing the local loop comprise the costs of trenches to the house copper cable. The copper itself comprises a further 25 per cent of the total costs of the local loop. Both of these infrastructures are fixed costs with respect to the output of subscriber lines: the same level of trench and cable costs would be

¹⁰ FCC, Implementation of Local Competition Provisions in the Telecommunications Act, First Report and Order FCC 96-325, at page 10

incurred by a ubiquitous operator in an area that achieved 10-20 per cent subscription penetration as Telstra with its 95 per cent penetration.

- 17.5 In total, NERA assessed the quantum of trench and cable costs to construct a fixed local loop on the scale of Telstra's current network at over \$10 billion as shown in table 3.2 of the Final NERA report reproduced below¹¹:

Breakdown of Investment Costs in the Access Network (Option 1 Values)

	Investment (\$ million)	% of total
Pillars	\$ 314	2%
Copper cable	\$ 3,497	25%
Trench	\$ 6,709	47%
Line cards	\$ 2,392	17%
Other non-traffic sensitive parts of switch	\$ 1,047	7%
Additional costs for remote rural customers	\$ 220	2%
Total	\$ 14,178	

- 17.6 The Commission's current inclusion of our service in the declaration increases our costs, which makes the economics of rolling out network more difficult and reduces incentives to invest. The effect of this is to reduce facilities based competition to the detriment of consumers.

18. Declaration increases barriers to entry by increasing risk

- 18.1 The increased costs and method of pricing in arbitrations currently proposed by the Commission will increase our risk and reduce incentives to invest.
- 18.2 Professor Hausman has pointed out that:

“Modern financial economics theory demonstrates that the desirability of each project must be judged on a project by project basis. If a given project is only permitted to earn at most its risk adjusted cost of capital ... the average return across all projects will be below the normal commercial return because less successful projects will earn zero or less than the allowed amount. This truncation of project returns will cause the new entrant to earn below its risk adjusted cost and capital and investors will not provide the necessary funds for new services and projects”.

¹¹ “Estimating the Long-run Incremental cost of PSTN Access”, Final Report for the ACCC, prepared by NERA at pg 46.

- 18.3 If the Commission were to adopt its current proposed avoidable cost approach to setting local call resale prices on a new entrant's network (in any subsequent arbitration) the new entrant would be more adversely impacted than Telstra. The avoidable cost methodology takes the standard retail price and then subtracts those costs which are avoidable given the incumbent is no longer providing the full service, such as product management, marketing and customer service costs. The Commission has currently accepted that Telstra's standard discounted retail offering is 22 cents. In relation to Cable & Wireless Optus, our standard discount is 20 cents. A strict application of this principle means that, assuming that our avoidable costs are roughly equal, that Cable & Wireless Optus would have to provide local call resale at a lower price than Telstra.
- 18.4 In this instance the Commission would be effectively applying asymmetrical regulation to a new entrant. This would be an unfortunate world first.

19. Declaration acts as a disincentive to reduce prices

- 19.1 The declaration and possible application of an avoidable cost methodology to new entrants' networks acts as a disincentive to those new entrants reducing their prices. The declaration means that new entrants potentially face regulation of their prices which would more adversely impact on them than on Telstra. If they were to reduce their retail prices, it would mean that they would need to reduce their wholesale prices to below Telstra.
- 19.2 This fact currently acts as a disincentive to Cable & Wireless Optus reducing our retail prices and competing in the retail local call market. This means consumers do not benefit from as high reductions on our network as they might if the local call service declaration did not apply to our network.

20. Impacts adversely on incentives to invest

- 20.1 The Commission should grant new entrants, such as Cable and Wireless Optus, an exemption from having to supply wholesale local call services over our networks because not granting such an exemption will adversely impact on our incentives to invest.

21. Declaration does not encourage the efficient use of investment

- 21.1 As the Commission has stated numerous times economic efficiency has three components:
- (a) Productive efficiency refers to the efficient use of resources within each firm such that all goods and services are produced at least cost;
 - (b) Allocative efficiency refers to the efficient allocation of resources across the economy such that the goods and services that are produced in the economy are the ones most valued by consumers, and allocated to the

highest valued users.

- (c) Dynamic efficiency refers to the efficient deployment of resources between present and future uses such that the welfare of society is maximised over time. Dynamic efficiency incorporates efficiencies flowing from investment and innovation leading to the development of new services, or improvement in production techniques.

21.2 The inclusion of new entrant networks in the current local call services declaration does not advance economic efficiency for the following reasons:

- The continued declaration of new entrant networks does not advance allocative efficiency because it will cause new entrants to use resources to develop a product for which there is not a market and divert resources from other products. It lowers facilities based investment and entry in alternative local telecommunications networks. This is the antithesis of good competition policy;
- Compelling new entrants to provide this service will increase industry-wide costs above the level that would occur absent declaration of new entrant networks; and
- Continued declaration of new entrant networks does not advance dynamic efficiency because new entrants, when faced with potential price regulation by the ACCC, have no incentive to lower prices and costs. More importantly, new entrants also have no incentive to invest in new infrastructure where that infrastructure will be covered by a declaration which, in reality, is applied to them in a more adverse way than it is applied to Telstra.

22. International approaches to access

22.1 Recent reviews of regulation of electronic communications markets in the EU, New Zealand, UK and Ireland have concluded that access regulation should be targeted at significant market power.

22.2 The proposed Directives from the 1999 European Commission Review, which were issued on 12 July 2000, represent the consolidated set of principles to emerge from the Commission's comprehensive review and analysis of forward-looking regulatory policies. It focuses on a timeframe of 2002–2007.

22.3 One key feature of the EU's proposed regulatory regime is regulation of access and interconnection based on significant market power (asymmetric in its practical application). The Commission stated that a provider could be held to have significant market power if that provider had the power to behave independently of competitors, customers and ultimately consumers.

22.4 The important competition test to determine this newly defined SMP threshold is whether the carrier has greater than 50 % share of the relevant market. At

market shares below 50 % the onus of proof is placed on the regulator to show why the competitor's network needs be subject to access regulation. And under the new SMP test, the case for regulation of a new entrant with less than 10 % market share would not even be considered: exemptions from access regulation would automatically granted without any recourse to competition analysis.

- 22.5 The Commission proposed that the extent of access and interconnection regulation should be linked to an assessment of the access provider's power in the wholesale market in which the relevant access or interconnection service is provided. The Commission considered that this asymmetrical approach was consistent with a minimalist approach to regulation.
- 22.6 The Commission believed that regulation should only apply where market forces are not functioning effectively and that regulation should be withdrawn once competition is sustainable:

“...ex ante regulatory obligations designed to ensure effective competition are justified only for undertakings which have financed infrastructure on the basis of special or exclusive rights in areas where there are legal, technical or economic barriers to market entry, in particular for construction of network infrastructure, or which are vertically integrated entities owning and/operating network infrastructure for delivery of services to customers and also providing services over that infrastructure, to which their competitors necessarily require access.”¹²

- 22.7 The justification for this hybrid approach is that it acknowledges the prospect of effective competition but accepts the reality of significant bottlenecks or essential facilities remaining subject to ineffective competitive and controlled by the local fixed network incumbent over the relevant period.
- 22.8 The New Zealand Ministerial Inquiry into Telecommunications considered the appropriate regulatory regime for a 2000 - 2005 timeframe. The draft report recommended abandonment of general competition law, in favor of communications-specific regulation based on the Australian model.¹³ Telstra's 50% owned New Zealand company has endorsed the draft recommendations of the New Zealand Inquiry.
- 22.9 The New Zealand Inquiry recommended, amongst other things, the establishment of a comprehensive, sector-specific regulatory regime targeted at

¹² EC Proposal on Common regulatory framework, July 2000 at 11.

¹³ New Zealand is the only empirical example to which incumbents advocating sole reliance on general competition law could point.

the market power of the incumbent including both an access regime and behavioural rules.

- 22.10 In relation to the UK, a review is currently being conducted of its Telecommunications Act. In July 2000, the UK regulator, OFTEL, published a statement of its views on the key features of future regulation.
- 22.11 In its statement, OFTEL identified the importance of ex-ante regulatory requirements on network and facilities' operators with significant market power to ensure that they offer interconnection on a non-discriminatory basis, publish prices and set out the terms on which they provide interconnection.
- 22.12 Similarly, a key feature of the regulatory regime in Ireland is the targeting of regulation where it is most needed – at operators with significant market power.

23. Conclusion

- 23.1 Cable & Wireless Optus believes that, whilst competition in the local call market is increasing, the lack of viable alternatives and the fact that Telstra still has substantial market power in the local call market means that the Commission should not grant Telstra the requested exemption.
- 23.2 At the same time, the Commission should acknowledge the inappropriate nature of the original service description and refine the original declaration to include line rental and operational support systems on the basis that Telstra has taken advantage of the current bare bones service description to provide these undeclared services on discriminatory and anti-competitive terms.
- 23.3 Cable & Wireless Optus also supports the granting of a carrier-neutral class exemption which would apply to those carriers without substantial market power. Granting such an exemption would remove the disincentive for new entrants to invest or reduce prices which has been a feature of the current declaration service description. Such an approach would also be consistent with overseas approaches to access and interconnect regulation.