

# Future Scope of Wholesale Local Call Regulation

## Submission by PowerTel Ltd

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On 9 August 2000 the ACCC issued its discussion paper on the Future Scope of Wholesale Local Call Regulation, and sought submissions by 4 September. This paper is PowerTel's response to the ACCC's request for comments.

### 1. BACKGROUND

In July 1999 the ACCC declared the local call carriage service involving the supply of voice bandwidth carriage services end to end between two points within a local call area, the service being used to supply local calls between two end users in the same standard charging zone. The Commission's declaration was in the context of declaration of the unconditioned local loop service and Local PSTN originating and terminating services. In April 2000 the ACCC issued a draft report on pricing principles for the local carriage service.

Subsequent to that declaration, the ACCC has been asked to arbitrate a number of access disputes in relation to the supply of the terms and conditions of supply of the service by Telstra, and has made an interim determination in relation to one arbitration relating to Cable and Wireless Optus.

Telstra has now sought exemption from its obligations to supply the local carriage service to its competitors in the CBD areas of Melbourne, Sydney, Brisbane, Adelaide and Perth. Telstra will seek further exemptions over a 12 month period. The Commission has decided to consider a class exemption for other carriers.

The Commission seeks submissions on three key issues:

1. The individual Telstra exemption;
2. The class exemption; and
3. Future variations to the declaration of the local carriage service.

The ACCC has not made available supporting information provided by Telstra in relation to the exemption application, if any supporting information was in fact made available. The information contained in the Telstra request at Attachment A to the discussion paper, paragraph 2(c), is unsubstantiated.

### 2. KEY ISSUES

PowerTel and many other operators have purchased the local call resale service from Telstra on commercial terms and conditions before the service declaration. New entrant operators take the view that it is essential they have the ability to sell local call services as part of a whole of business offering, in order to be able to compete in the telecommunications market as a whole (and not just the long distance and international market). PowerTel has relied upon commercial terms and conditions for supply of these services to date.

The service declaration has been in effect for less than 15 months - a short time in the context of the regulatory regime. The large number of arbitrations on the local carriage service is evidence of widespread dissatisfaction with the commercial terms and conditions on which Telstra makes the

service available. The ACCC has not made public the issues arising from the arbitration requests put to it. PowerTel is itself considering its position in relation to referral of terms and conditions of supply to the ACCC.

Another cause for concern is the fact that the emergence of competition in two or three cities is being used as a precedent for exemption of services in all cities and regions of Australia. If accepted, this would send the wrong signals to the market and frustrate the objectives of

- promotion of the supply of diverse and innovative carriage services and content services;
- promotion of the effective participation by all sectors of the Australian telecommunications industry in markets (whether in Australia or elsewhere).

## **2.1 THE INDIVIDUAL TELSTRA APPLICATION**

PowerTel does not have accurate figures available as to the extent of competition within the local call market in the CBD areas (however defined by the ACCC rather than Telstra: Telstra should be required to make publicly available specific definitions and maps of affected areas relating to its submission). Recent press reports indicate that around 800,000 customers Australia wide have chosen a provider other than Telstra to supply their local call service. While these figures do not differentiate between customers who are directly connected to other carriers and those which are simple resale customers, the figure represents less than 10% of the market Australia wide. Our assessment is that competition for local calls in the CBD areas (loosely defined to be the central business area of each city) could be no more than a range of half to two thirds of customers in the CBD areas of Sydney and Melbourne. Brisbane, Adelaide and Perth would be expected to have even lower average competition rates - possibly around a third to a half of customers at best. Even where competition is supposedly most intense, it is not for the whole of the available market.

The market for local call services has undergone a substantial price shakeout in the period since the ACCC's declaration of local carriage services, with a substantial reduction in retail pricing of local calls to end-user customers. Most operators do not offer local calls at the old Telstra PSTN rate of 25 cents per call. Telstra itself has substantially reduced its published tariff and introduced a variable charge structure, with local calls between two customers in the same exchange area attracting a substantial discount over other local calls. It could be argued that the effect of the declaration has been to deliver tangible benefits to the end user.

Unfortunately this new level of pricing has not been via reduced wholesale rates as expected and industry may well find it is unable to be maintained.

Wholesale prices for these services have never been on a cost based methodology, and the ACCC has confirmed its approach of retail minus pricing. Wholesale prices have not followed retail prices down to the same extent, and Telstra's retail intra exchange area service is understood to be priced below the current wholesale price to other operators. PowerTel understands that most resellers also do not obtain the advantage of the differentiated pricing for calls at the wholesale level, for example within the same exchange area. Clearly these activities indicate that consumers are obtaining the benefit from local call resale via the local carriage service, but the competitive wholesale position for operators is yet to stabilise. As noted by the ACCC, most companies currently resell the local call service as a loss leader (ie below the wholesale price for the local carriage service).

Either the retail minus approach is still not effective, there are other non-price based competitive factors at play, or there is a compelling commercial imperative to offer a deeply discounted local call rate. Given most new entrants use the local carriage service as loss leader, it would appear that price is one of the major issues of contention between Telstra and new operators.

The ACCC also raised the extent to which substitutable services are also available, including for example, the unbundled local loop and local or domestic PSTN originating or terminating services at points closer to the customer connection. PowerTel notes that

- there is considerable publicity about new technology services, but the availability on a wide scale (similar to fixed wire services) is virtually non-existent at present either in the CBD areas of cities or elsewhere. We anticipate this will be at least 1-2 years away;

- the unbundled local loop service has still to be implemented on a large scale basis and tested in the market for successful implementation. Thus to claim “availability” (or anticipated availability) represents competitive choice ignores the issue that there is no record of success of the implementation of the service or commercial acceptance of the service in the market place;
- access to local PSTN originating or terminating services closer to has not been implemented (see earlier comments about availability).

PowerTel considers that in the light of the above, the effect of declaration of the service has yet to become known. Accordingly, the declaration should continue in force as a market discipline for at least another 2 years.

## **2.2 THE CLASS EXEMPTION**

Regardless of our view that the service should remain declared for another two years, PowerTel considers that any exemptions under s 152 AT of the Trade Practices Act 1974 should be on the basis that an exemption is granted to all industry participants. This is an issue of market power and vertical integration.

The dominant incumbent is the only operator with ubiquitous reach throughout the country, also emphasised in the CBD areas proposed. The wholesale resale service is the major means by which new operators are able to offer local carriage services as part of a bundled whole of service offering to retail customers – other alternative wholesale services have not yet been introduced on a widespread basis. The pricing of any new proposed services is still contentious, and not sufficiently tested in the market place.

To provide the dominant incumbent with an exemption would render the declaration of the service meaningless from the competition viewpoint – for example the services offered by non-dominant and smaller operators would be regulated, and these would only be in limited areas of the CBDs. However, the ubiquitous CBD local call carriage service of the dominant incumbent would not be regulated.

If the dominant incumbent is granted an exemption, its ability to bundle this base level service with other services would be enhanced, possibly in such a way that it could prevent the development of competition across the market place as a whole. It will also signal the need for new entrants to duplicate infrastructure (even more than is currently the case) in order to enable new entrants to compete effectively in the long term, given the current dissatisfaction levels and number of arbitration requests before the ACCC.

If an exemption is to be provided to Telstra on the basis of the ACCC's assessment on the extent of actual competition for local carriage services in these CBD areas, a class exemption should be provided to all operators.

## **2.3 FUTURE VARIATIONS TO THE DECLARATION OF THE LOCAL CARRIAGE SERVICE**

The ACCC seeks submissions on the appropriate timing for potential variations to, or even revocation of, the local carriage service declaration, if any.

PowerTel believes that there really is no time limit that will determine when a declaration in respect of any particular service should be revoked, it is determined by the state of competition. With regard to the current market status we estimate that LCS resale may be ready for revocation of the declaration in around two years time.

In terms of the issues within this broader question, the local carriage service declaration should only be revoked when

- it can be demonstrated that there is a decrease in consumer benefit arising from the resale of local calls; or
- when the utilisation of the service falls substantially below current levels, or does not show any growth for successive periods. This will demonstrate that
  - alternative technology services have succeeded in displacing this service;
  - use of the unbundled local loop service has been effectively implemented, either as a total product or as a component service;
  - competitive carriers have succeeded in connecting sufficient numbers of customers to their own networks.

The onus of proof on whether the above is occurring should be on the proponent for removal of the declaration, by providing the ACCC with supporting data.

Accordingly, PowerTel recommends the ACCC should commence the review of the need to revoke or vary the existing determination in around 20 months time. This would give the implementation of ULL, XDSL and other services a reasonable settling period in the market place, so that alternative means of delivering local call services can be tested.

### **3. CONCLUSION**

Most new operators utilise this declared service as part of a whole of business package, in order to be able to offer the convenience of the one stop shop and one bill. While there are a number of steps being taken to encourage the development of alternative means of accessing customers to provide local call services, these remain to be introduced on a full scale commercial basis, and have yet to be tested in the market as to feasibility and commercial acceptance. It is the same with the development and implementation of new technology solutions.

Other carriers are building networks to achieve direct connection with customers in the major population centres of Australia. It could be said that none of these operators (with the possible exception of C&W Optus) have reached critical mass in terms of investment returns or net positive cash flows from these investments.

New operators had purchased local carriage services from the incumbent prior to the declaration of the service. The absence of regulation, together with Telstra's pricing arrangements both for the wholesale service and the retail charges to customers, contributed to the decisions to build alternative infrastructure. The number of arbitrations indicates dissatisfaction with the terms and conditions on which the service is supplied.

A substantial restructuring of retail pricing, which has led to consumer benefit, occurred at the same time as the service declaration. Telstra itself now offers substantially lower rates for local calls. There has been some restructuring of the wholesale charging arrangements following the publication of the ACCC's position on pricing of these services, but not to the extent that prices have fallen in the retail market.

End users have therefore benefited from the declaration. The current benefits to end-users may be lost as a consequence of an exemption, with possible adjustments to wholesale terms and conditions also leading to retail price increases.

Granting of exemptions to incumbent alone would be inconsistent with the objective of regulation, with regulation being confined to non-dominant operators who do not offer ubiquitous services. It could reverse the gains made, and encourage further inefficient infrastructure duplication.

PowerTel recommends that the ACCC reject the request for exemption of Telstra Corporation's local carriage services on the basis that it has not demonstrated that its request would be in the long term interests of end users.

