Public Policy and Communications

Regulatory Affairs General Manager
Unit 11, Level 2
11 National Court
BARTON ACT 2600 Australia

Telephone 02 6208 0740
Facsimile 02 9218 3836

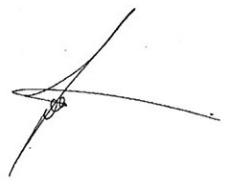
1st September 2006

Gabrielle Ford
Australian Competition & Consumer Commission
GPO Box 520
MELBOURNE VIC 3001
Facsimile: 03 9663 3699

Dear Gabrielle,

Please find attached Telstra's second submission in response to the ACCC's position paper on its strategic review of the regulation of fixed network services.

Yours sincerely,



Tony Warren
General Manager –Regulatory Affairs
Public Policy and Communications

TELSTRA CORPORATION LIMITED

Submission to the Australian Competition and Consumer Commission

Response to the Commission Position Paper June 2006

"A strategic review of the regulation of fixed network services"

September 2006

1. Executive Summary

The Position Paper, together with recent decisions of the Commission, clearly articulate and illustrate the Commission's ongoing support for the "stepping stone model" of regulation in interpreting Part XIC of the Trade Practices Act. This is a failed policy. It is a failed policy because it has failed to deliver investment in alternative infrastructure which would lead to a sustainable competitive market in the telecommunications sector. The "stepping stone" policy is also out of favour in the international arena because it has proved itself to do more harm than good. The record in Australia and globally clearly shows that the Commission's approach to regulation eventually destroys new entrants and chills investment by incumbents, leaving businesses and household consumers with much less than other developed nations with whom we compete.

The Commission's policy should be wound back, not extended. This involves scaling back the number of duplicative and overlapping regulated services. How the Commission can continue to justify expanding the number of regulated services remains unclear. It also involves scaling back the remaining regulated services to those areas where bottlenecks remain – simply assuming the whole country is a bottleneck is a failure to fully discharge its regulatory function and violates the policy intent behind the current legal framework.

If the policy is not wound back Australia will continue to languish in the international slow lane, leaving Australia a backwater when it comes to broadband speeds and the life-changing, bandwidth-hungry applications and services that can run over the new types of networks that other countries are already using to improve their quality of life and to compete with Australian businesses. The significant fixed network investment that this country needs in new communications infrastructure will not occur with the way the Commission currently interprets regulatory settings.

A change of policy and approach to the interpretation of Part XIC is required. Prerequisites include policies that are competitively and technologically neutral. An approach is required that uses facts and data and pro-investment regulatory settings to free the dynamics of market forces which produce pro-investment and pro-competitive outcomes.

In this regard, there is absolutely no justification for the Commission to declare xDSL services whilst it has an ongoing declaration of ULL in the upstream market and at a time when both the wholesale and retail markets are fiercely competitive.

2. A failed policy

The Position Paper makes it clear that the Commission continues to endorse the stepping-stone or ladder-of-investment model of telecommunications regulation[1] - the idea that entrants in telecommunications markets need one or more levels of access to existing platforms in order to acquire customers and build scale, ultimately allowing them to become sufficiently profitable to invest in infrastructure build-out, thereby climbing the "ladder of investment".

Telstra has previously criticised this model and repeats those concerns[2]. A comprehensive review of the stepping-stone or ladder-of-investment model has been conducted by the respected British consultancy group, Indepen, for the Brussels Round Table of leading European telecommunications operators and equipment manufacturers, and is reproduced with permission at Attachment A[3].

Concerns with the stepping-stone or ladder-of-investment model are appearing right around the world.

In the US, incumbent carriers were required to unbundle their networks and provide those elements at regulated prices. This encouraged virtually riskless market entry as most of the DSLAM roll-out was vendor financed.

> "In 1999, some 300 competitive local exchange carriers (CLECs), with a total capitalization of some $86 billion, were operating in the United States[4]. The next few years, however, brought a wave of bankruptcies and liquidations. Today [2002], only 80–100 survive, with a total capitalization of some $4 billion[5]. The biggest names in the industry, including Covad, NorthPoint, Teligent, and Winstar, have filed for bankruptcy protection[6]."[7]

---

[1] See page 13 of the Position Paper where the Commission refers to its advocacy of the stepping stone model – although it does not consider that full facilities based competition is the end goal in all circumstances. Also at page 13 where the Commission does not consider that competitors appear to be basing their business on access to Telstra's services rather than building their own facilities as indicating a problem with the stepping stone model. See also page 14 where the Commission provides a diagram which questions whether a wholesale service declaration is needed as a ***stepping stone*** to ULL competition in some areas.

[2] See pages 15 to 17 of Telstra's response to the Commission Proposal – "A Strategic Review of the regulation of fixed network services", February 2006.

[3] Appendix to "Restoring European economic and social progress: unleashing the potential of ICT", a report by Indepen for the Brussels Round Table of leading European telecommunications operators and equipment manufacturers: Brian Williamson, Phillipa Marks, David Lewin, Justine Bond and Helen Lay.

[4] Association for Local Telecommunications Services, Progress Report on the CLEC Industry, October 17, 2002.

[5] Ibid.

[6] For an analysis of some of the factors behind this financial "meltdown," see Larry F. Darby, Jeff A. Eisenach, and Joseph F. Kraemer, "The CLEC Experiment: Anatomy of a Meltdown," Progress and Freedom Foundation Progress On Point 9.2, September 2002.

[7] James L. Gattuso, "Local Telephone Competition: Unbundling the FCC's Rules," The Heritage Foundation, February 10, 2003, http://www.heritage.org/Research/Regulation/bg1621.cfm.

The US telecommunications industry went through a lot of pain and suffering before the FCC saw the error of its ways and changed course to become a pro-investment, pro-real competition regulator. From an initial rush of investment the sentiment quickly changed to the following:

> "If you are a CLEC whose entire strategy is built around selling unbundled network services, you probably ought to find other work."[8]

Attachment A contains extracts of the FCC's reasoning in reversing its unbundling requirements, they include:

> "...this regulation can have a significant impact on the ability of wireline platform providers to develop and deploy innovative broadband capabilities that respond to market demands. The record shows that the additional costs of an access mandate diminish a carrier's incentive and ability to invest in and deploy broadband infrastructure investment."

Similarly, the recent review of telecommunications regulation by the Canadian Government found that the stepping stone model is not the way forward:

> "There is no evidence in Canada that the CRTC's "stepping-stone" strategy has provided an effective transition to greater reliance by entrants on their own facilities. There is, on the other hand, reason to believe these policies have distorted the behaviour and incentives of new entrants in Canadian telecommunications markets.
>
> When wholesale access to particular essential facilities is mandated after new entrants have already constructed comparable facilities, the value of these entrants' network investments is reduced.
>
> Therefore, while the CRTC has identified facilities-based competition as an objective of its regulatory framework, it has adopted mandated wholesale access policies that, in the Panel's view, seriously undermine, if not foreclose, the achievement of that objective.
>
> One argument advanced in favour of a very broad scope of mandated wholesale access is that such an approach would promote all forms of competition by making it easier for competitors to resell any portion of the ILEC's network that they want. However, in the Panel's view, a broader scope makes the distortion of entry and investment decisions more pervasive. For this reason, a broad scope of mandated wholesale access would not in fact promote all forms of competition. Rather, it would promote only one form of entry (i.e. resale), thus perpetuating disincentives for new entrants to build facilities and

[8] Jennifer Jones, "CLECs play a new tune," *Network World*, 08/22/05, citing Mitchell Brecher, an attorney specializing in FCC matters at a Washington D.C. law firm, http://www.networkworld.com/research/2005/082205-clecs.html.

entrenching the ILECs' SMP over the network and its elements. This would extend the need for a broader scope of regulation than would otherwise be necessary."[9]

The Canadians recognise that a new approach is required:

> "...today's telecommunications markets are very competitive, dynamic and complex. This undermines the effectiveness of economic regulation in many areas and introduces new costs... Consequently, even where market forces operate imperfectly, one can no longer assume that regulation will automatically produce a better result."[10]

Analysts in Europe also point to the chilling effect on investment produced by the stepping-stone model:

> "[A]lthough we expect some fibre build, particularly...for VDSL in European countries with cable competition, we still see the regulatory backdrop as unsupportive of a sustained increase in capital intensity."[11]

> "The dominance of free cash flow yield (FCFY) valuation measures in Europe is testament to the fear and suspicion with which the market regards investment in capex. The focus on FCFY has sent company management teams a clear message – spend as little as possible on network..."[12]

> "We...see little incentive from a regulatory perspective for incumbents in Europe to pursue FTTP [Fibre to the Premises]."[13]

3. An incorrect approach to implementing a failed policy

The above clearly shows that the Commission's continued endorsement of the stepping-stone model is out of kilter with international regulatory thinking. However, the Commission's departure from international standards is even more pervasive. In Europe, some level of resale based competition is encouraged. However, there is a considerable departure between the ***way*** in which the Commission applies its regulatory levers compared to the way in which similar powers are applied in Europe (see Part 5 below).

The Commission has recognised that there are other approaches to implementing the stepping-stone model. For example, in the Position Paper the Commission notes:

---

[9] Telecommunications Policy Review Panel, Final Report 2006, Chapter 3, Economic Regulation, page 35.
[10] Ibid, Chapter 2, Policy Objectives and Regulation, page 11.
[11] Merrill Lynch, June 2006 (cited in Telecom Markets, 13 June 2006)
[12] HSBC Global Research, Telecoms and Media. April 2006. "Net Neutrality"
[13] Credit Suisse First Boston. July 2005.

> "One view is that formal access regulation should focus wherever possible on the deepest network level at which competition is (or will become) feasible. This is thought to promote the most sustainable and effective form of competition."

This view is similar to the position Telstra urged the Commission to adopt in its previous submission. The Commission should only be regulating the "bottleneck" hotspots and in those bottleneck hotspots – it should only be regulating the bottleneck service. For example, if ULL is available, then it can be used by entrants to provide voice and data fixed services. It means that it is not necessary to declare PSTN OA, the local call service, wholesale DSL services etc...

By reverting to its support of the stepping stone model the Commission seems intent on continuing to provide access seeks with every flavour of access imaginable - even though this approach is not required to meet the long term interests of end users. The stepping-stone model is now apparently an end in itself.

> "Another view is that access regulation should (be) seen as a set of tools which should be directed at facilitating further investment in network services in the longer term, **but should also** provide for service providers to develop a retail customer base before the more extensive network investments are required (hence reducing the risk for service providers)."[14]

Even in the face of infrastructure based competition, the Commission argues that regulation is still necessary:

> "In addition, a large retail customer base is typically necessary to justify investment in infrastructure before a new entrant can compete effectively with Telstra. To date, competitors generally seek to build scale in retail markets through the resale of other wholesale services."

Accordingly, when faced with a decision whether it should wind back regulation, the Commission has introduced the concept of "effective competition". It states that the starting point of any analysis is whether there is "*effective facilities based competition or contestability*"[15]. This is not the test under the Act. The test for the Commission to consider as to whether declaration should continue is the same as whether it should declare a service in the first place, whether declaration is in the long term interests of end users as defined in the Act. It is true that **one limb** of the LTIE test is the objective of **promoting** competition. However, that objective must be balanced with

---

[14] At page 87.

[15] Page 14 of the Position Paper. Here we assume that the Commission is reflecting the definition of "effective competition" as set out in Re Queensland Co-Op Milling Association Ltd and Defiance Holdings Ltd (1976) ATPR ¶40-012, 17,246.

the objectives of achieving any-to-any connectivity and, importantly, the objective of encouraging efficient **use of** and **investment in** infrastructure[16].

Not only is the concept of "effective competition" contrary to the LTIE test under the Act, it is conceptually incorrect. The pre-existing conduct regulation in Parts IV and XIB of the Act is already designed to achieve workably competitive outcomes in circumstances where a firm has market power. The Commission should not continue to apply access regulation in circumstances where conduct regulation is already sufficient. The appropriate threshold for removal of access regulation is the point at which conduct regulation alone is insufficient to promote "effective competition".[17]

Furthermore, it is important that the concept of effective competition is assessed in the overall market context. Australia is a small economy with naturally more concentrated markets[18]. Network-based markets are themselves inherently more concentrated. It is entirely possible that a telecommunications market in Australia can be workably competitive in circumstances where only a few facilities-based competitors exist.[19] The Commission should recognise the extent of competition that has already been achieved over the last decade – and should be more realistic about what further competition is actually achievable in the particular context by continued structural regulation. As competition develops, regulation should be commensurately relaxed.

However, the Commission's reasoning appears to be that it will only relax access regulation once effective competition is achieved. Indeed, this is apparent through the Commission's recent decisions, where it has all but admitted that it has over regulated and then encouraged the use of exemption applications to wind back its over-regulation. In the Commission's Final Decision in the Local Services Review, July 2006, the Commission stated:

> "However, the Commission notes the availability of a formal ex post process available through the granting of exemptions from the Standard Access Obligations. This would allow applicants to seek exemptions from regulation of particular regions."[20]

---

[16] See page 251, National Competition Policy: report by the Independent Committee of Inquiry (Hilmer Report), August 1993. Hilmer commented in his initial recommendations, for example: "*Moreover, when considering the declaration of an access right to facilities, any assessments of the public interest would need to place special emphasis on the need to ensure access rights did not undermine the viability of long-term investment decisions, and hence risk deterring future investment in important infrastructure projects*".

[17] In this regard, Telstra sees "effective competition" as the process of competition and not any particular competitive outcome or industry structure.

[18] See, for example, discussion in M Gal "Competition Policy for Small Market Economies" (Harvard University Press, 2003) in which she identifies that small economies are characterised by high concentration levels due to the size of minimum efficient scale relative to domestic demand.

[19] The Productivity Commission, for example, has concluded that "*the mobile services market appears to exhibit characteristics of an effectively competitive market*". The same conclusion was reached by the FCC in the United States notwithstanding. See, for example, FCC, *10th Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services*, 30 September 2005, para 2. Similar decisions have been reached by other regulators around the world, including in the context of recent merger clearances in Canada (4 to 3 merger) and the Netherlands (5 to 4 merger).

[20] Ibid.

The Commission's over regulation is evident not only on a geographic basis but also on a temporal basis. The Commission declared services for three years as follows:

> "The Commission must commence a review of the declaration within the 12 month period prior to the expiry date. The Commission therefore considers that it would be appropriate for the declarations to apply for three years from 1 August 2006 until 31 July 2009. A three year declaration period will mean that, at the commencement of the next review of these declarations, the currently uncertain state of competition and infrastructure deployment should be evident, and the Commission will accordingly be better able to assess the appropriateness of continued declaration."[21]

The Commission is giving itself a full year in which to conduct a backward looking review of the market – even though the market may be competitive during this time. Telstra's previous submission on the Position Paper has pointed out that this approach is costly and distortive, requiring multiple regulatory processes with the persistence of over-regulation negatively impacting market dynamics.[22]

Part XIC gives clear direction to the Commission that it should balance the objective of the promotion of competition against the remaining statutory factors, particularly the adverse impact of regulation on investment. In this context the Commission should be mindful of the fact that Telstra has consistently been overwhelmingly the most significant investor in telecommunications infrastructure in Australia and will continue to do so into the foreseeable future[23]. Any regulatory decision to dull Telstra's investment incentives necessarily means the decision dulls the overall investment incentive.

Pursuing the objective of competition without appropriate analysis is to determine whether the continued costs of heavy-handed Part XIC regulation outweigh the benefits of a more light-handed approach is not sanctioned by the legislation. If the Commission can achieve workable competition by conduct regulation, the Commission should obviously favour conduct regulation. Over-regulation can be as costly as no regulation at all.

4. A new approach

The European public consultation on a draft Commission recommendation on relevant product and services markets within the electronic communications sector susceptible to ex ante

---

[21] Page 9.

[22] See paragraphs 6 and16 to 18 of Telstra's first submission in response to the Position Paper, July 2006.

[23] Even though Telstra was unable to proceed with its investment in fibre-to-the-node as it was not able to reach an understanding with the Commission on the facts of servicing high cost areas, Telstra is nevertheless proceeding at pace with its investment in its new 3G 850 network. In markets where there is less regulation and thus more investment incentive, Telstra's investment dollars flow.

regulation[24] provides clear guidance as to how to approach the issue of access regulation. This is a clear market-based enunciation of the practical way in which the Commission can approach the LTIE criterion - conducting a market definition analysis, determining where there is SMP and then seeking the appropriate remedy:

> "In general, the market to be analysed first is that market which is most upstream in the vertical supply chain. Taking into account the ex ante regulation imposed on that market (if any), it should then be assessed whether there still is SMP on a forward-looking basis on the related downstream market(s). This methodology has become known as the "modified greenfield approach". Thus the NRA should work its way further down the vertical supply chain until it reaches the stage of the retail market(s). A retail market should only be made subject to direct regulation if competition on that retail market still exhibits SMP in the presence of wholesale regulation in the related upstream market(s).
>
> For example, with regard to wholesale broadband access, it is recommended that NRAs first analyse the market for local loop unbundling. Taking into account regulation imposed on that market, the market for wholesale broadband access should then be analysed. If that market continues to exhibit significant market power on a prospective basis despite the presence of LLU regulation (unless the NRA finds that the market no longer fulfils the three criteria test and excludes it from regulation on that basis), appropriate regulation on the wholesale broadband access market should be imposed.
>
> Likewise, NRAs should take into account regulation imposed on the market for local loop unbundling when analysing the wholesale market for fixed origination. Remedies imposed on the markets for local loop unbundling should then be taken into account when assessing SMP on a forward looking basis on the retail fixed access market.
>
> Given that the analysis of these markets must be conducted within the context of the entire value chain from the wholesale input market through to the final output market, it is imperative that, for NRAs to be in (a) position to carry out their tasks, they should have access to data at all levels in the value chain. This is particularly pertinent in relation to the retail level.
>
> ...
>
> The interrelationship of markets should also be taken into account when determining and implementing remedies on the respective markets in order to ensure the effectiveness and consistency of the remedies imposed."

Telstra has serious concerns in relation to the way the Commission examines (a) market and hence determines the way it should (over) regulate the Australian telecommunications market

---

[24] 28 June 2006, SEC (2006) 837.

(see Part 5 for details). We suggest that, instead, what an effective regulator would have done, and should do, is to use the following principles when examining markets and making determinations in accordance with the criteria under Part XIC of the Act.

Start in the right place

The Europeans quite clearly advocate starting at the top of the vertical supply chain and for the regulator to work its way down. Instead, in Australia, for the forthcoming period, say 2006 to 2009 the exact opposite occurred:

- first we started off with the imposition of retail regulation, with the Ministerial Retail Price Control Determination , on advice from the Commission, which was formulated in 2005 and implemented in January 2006;
- then we had the Local Services Review, on the resale of local calls, which was commenced in April 2005, with a final decision issued in July 2006;
- the re-declaration of PSTN OTA and ULL (concurrently even though one is a resale service capable of supply through access to the other) was proposed with the publication of the Position Paper in June 2006 (with a two week response time from industry); and
- the question of declaration of xDSL services was mooted with the initial discussion paper in December 2005 and again with the Position Paper in June 2006.

Fact based information

Telstra's previous response to the Position Paper catalogued how the Commission has been basing its decisions in the complete absence of any robust data, illustrating that the Commission needs to improve its fact base. The Commission has now accepted that an infrastructure audit needs to be conducted[25].

Although an infrastructure audit is a good start, it is by no means the only hard factual material that the Commission should be actively gathering. Examples of others include retail market offerings (service bundles and features) and prices of competitors, the cross-shareholdings of competitors, the inter-industry tie ups and infrastructure sharing arrangements and the influence (and dollars on offer) of global equipment vendors.

---

[25] See page 16 of the Position Paper where the Commission states it is appropriate to conduct a more comprehensive survey of infrastructure. Telstra notes that the Commission had information available on actual and planned DSLAM roll-out in June 2005 for the purposes of its review of the IDSN Declaration (see page 46 of the Final Report) :

> *"The increasing rollout of DSLAMS by a number of services providers throughout CBD and metropolitan areas of capital cities in one indication of this trend. The Commission believes that the continuation of this trend over the next 12 months will lead to DSL infrastructure being widely available in CBD areas of capital cities and will also contribute to significant availability of DSL services in metropolitan areas.*
> *Confidential information available to the Commission indicates that significant investment is either currently being undertaken or has been committed to rolling out infrastructure to meet existing and forecast demand for higher speed data services."*

However, no mention has been made of such information in its recent declaration decisions.

Up to date

Once an infrastructure audit is conducted or other information is obtained, it needs to be kept up to date. Using information from years gone past is of no value at all. What was happening in the market three or four years ago is interesting from a historical perspective but should not be used to make decisions on how to regulate the market going forward. The Position Paper contains a chapter on "*Current and emerging competition and technologies*". However, information from 2002, 2003, 2004 does not provide any illumination whatsoever on current and emerging competition and technologies.

Forward looking

Collecting up-to-date information is not an end of itself. The facts of the market today then need to be reflected in the realities of what is going to happen in the future. For example, gathering information on the number of deployed DSLAMs is one thing. However, for a forward looking view, this information would need to be augmented by information on planned DSLAM deployment which the Commission could obtain from Telstra and from publicly available statements by those industry participants deploying DSLAMs. Such information would give a forward-looking view of the landscape of competitive infrastructure rollout.

We also recommend that the Commission monitor trends in certain comparable overseas markets which may shed light on possible market developments within Australia. For example, the take up of VoIP, mobile substitution for fixed lines and the kind of retail bundles and pricing initiatives taking place.

Properly contextualised

The Commission's analysis needs to be contextualised within the broader regulatory framework which the industry operates. For example, page 33 of the Position Paper points to the fact that economic theory suggests that the incumbent will face a strong incentive to discriminate against its competitors by providing lower quality or higher cost wholesale services. However, this particular "economic theory" does not stand up to the facts which are apparent from the accounting separation regime, and now Operational Separation, whereby some indicators show that not only are wholesale customers not discriminated against, but that wholesale customers get better results than Telstra retail does.

Another, perhaps more pressing example of the need for contextualisation is in relation to the Commission's pricing decisions where the public policy objectives of retail pricing parity between metropolitan and regional areas has significant impacts on market dynamics. Obviously serving more distant, geographically diverse and less population-dense areas creates higher costs for those servicing those areas. When areas of higher cost supply and pricing parity meet – there is necessarily a conflict which distorts the basic principles of market supply, and correspondingly

the principles of regulating markets. In this regard, the Commission needs to contextualise its policy making to the forward looking actuality of the Australian telecommunications landscape.

Biting the bullet

Where the Commission finds that markets are moving toward becoming competitive on a forward looking basis, it needs to bite the bullet and deregulate, safe in the knowledge that conduct regulation will ensure that the momentum is sustained.

The conduct of the Commission seems to infer that it is waiting for a situation where the declared service is no longer used by any competitor at all before it will deregulate. Is there some fear by the Commission that if a service is undeclared – Telstra will switch off services the next day? This is absurd. Commercial reality dictates that it will be in Telstra's interest to ensure that Telstra continues to wholesale services. Then when the day comes that Telstra does wish to exit certain services, there are many commercial imperatives to ensure that any transition is conducted with sufficient lead times and industry consultation to avoid disruption to end users – whether those end users are Telstra customers or not – in which case they are potential Telstra customers.

What is clearly needed is a rethink of approach, and through this submission Telstra has enunciated a fact-based, market-based and internationally recognised approach for the Commission to follow within the existing legislative framework until it is reformed. The Commission's approach has proven that it is not only incapable of providing modest gains using current networks, but that it is diametrically at odds with a world where legacy copper networks are gradually being replaced with fibre closer and closer to the end user. A world that requires billions of dollars worth of investment, together with vision and calculated risk taking on a grand scale. If a rethink is not had, Australia will be left behind as the rest of world has access to new, innovative technologies which provide better living standards and economic advantage.

5 The impact

Under the Commission's approach to access regulation, market participants who do not invest and provide no level of innovation, who are unable to achieve economies of scale and scope (and are therefore incapable of operating at efficient levels) are able to flourish. For example, Australia has amongst the highest number of ISPs per capita in the developed world.

For 10 years, the Commission has been fostering the development of resale-based competition in Australia. Ten years ago, this may have seemed sensible as the technologies capable of competing with Telstra's copper wire network at the infrastructure layer were sparse and expensive. Even so, large international telecommunications market participants, such as Cable and Wireless and Vodafone, were willing to tap their access to international capital markets to build infrastructure in Australia, such as the Optus HFC network and 2G mobile networks.

Ten years down the track the landscape is very different. There are many technologies which can and do compete with Telstra's copper wire network Regulating Telstra as if it were a monopoly simply flies in the face of actuality[26]. Telstra submits that the Commission needs do more than merely pointing to the fact that Telstra is a large market participant and a decision can automatically be made to regulate.[27].

What is perhaps more disturbing than the Commission's encouragement of pure resale-based competitors through its multiple declared service offerings and below-cost pricing is that the Commission has made it so easy for what it calls quasi-facilities based investment[28]. The Commission is particularly focused on driving the ULL price lower and lower to a level that is nowhere near Telstra's costs of providing the service – which keep increasing (see Chart). It has done so by not only issuing decisions which keep on lowering the price (see Attachment B), but through those decisions it has signalled that the prices should be, and if the Commission as regulator has its way, will be, even lower.

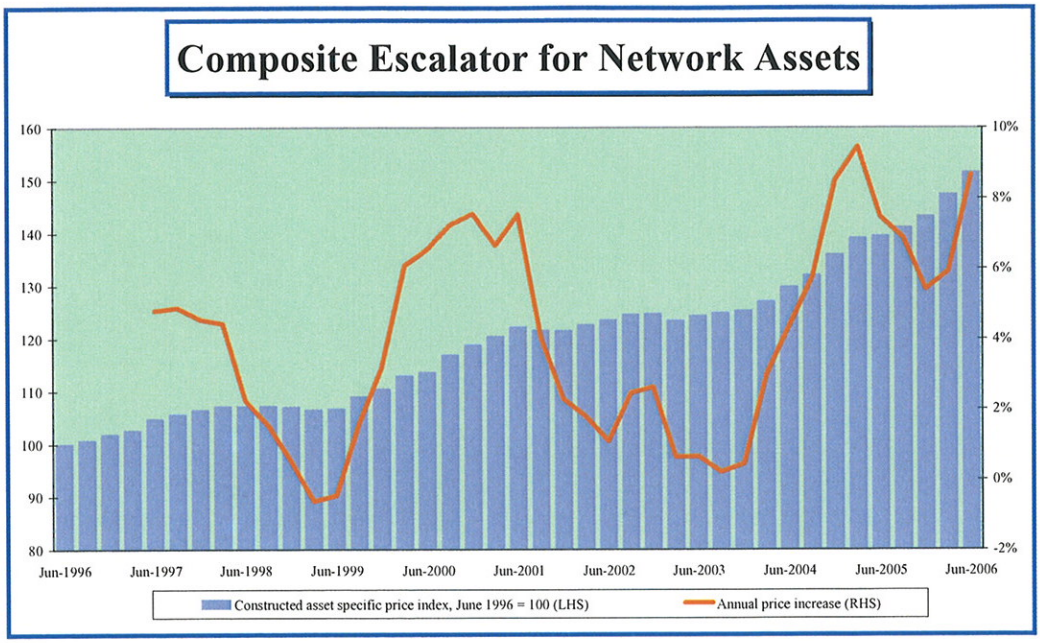
---

[26] The Commission's Chairman has oft-times and again recently equated Telstra with a monopoly: *"...like some other utility industries, telecommunications is an area where infrastructure is largely supplied by monopoly providers"*(Graeme Samuel, 24 July 2006, speech to the Australian Telecommunications Summit 2006). This statement just does not resemble fact. If you want to carry gas, goods, or electricity and there is only one gas pipe, only one railway line, only one electricity grid you have a monopoly. If you want to carry voice or data in Australia, you can do so via multiple networks, both fixed and wireless. You have many not mono. You have lots of choices not one choice. Factually, there is no monopoly and to persist with such an idea is not factual and is misleading.

[27] In a commentary dated 15 August, Grahame Lynch, states that *"first it requires an admission of the problem and an abandonment of the kibbutz-style economics that characterises what purports to be 2006 Australian telecom policy"*, Communications Day, page 5.

[28] See page 11 of the Position Paper.

Chart: Composite Escalator for Network Assets[29]



In this context, Telstra fully endorses the Commissions words in the Position Paper at page 13:

> "Competitors' decisions about the basis on which to compete will, in large part, depend on access prices relative to investment cost. So long as these signals are correct, the market should make appropriate decisions about whether to invest in alternative infrastructure, and/or rely on Telstra's network and the extent of this reliance. If access prices do not reflect efficient costs, or there are market failures or uncertainty, then competitors' decisions about whether to build or buy could be distorted."

The Commission's ULL pricing policies have had the exact effect that the Commission feared – investment decisions have been systematically distorted. Optus[30] and Transact[31] favour ULL over using and investing further in their own network infrastructure, an outcome that should only be viewed as perverse in the extreme.

But the Commission appears to ignore the effects on investment that it is causing. In a speech on 24 July 2006, which the Commission's Chairman made at the Australian Telecommunications Summit, Mr Samuel stated: "*I do not believe that economic regulation as practised in Australia has*

---

[29] Telstra has created a composite price escalator for the main network assets used in provision of the ULLS. The composite price escalator is based on individual constructed price escalators for the major CAN assets: main cable; main conduit and trenching; distribution cable; and distribution conduit and trenching. The individual price escalators capture costs associated with the materials and component equipment needed in the construction of these assets as well as the cost of the labour involved. The constructed escalators cover a 10 year period based on publicly available data from the Australian Bureau of Statistics.

[30] Since September 2003 Optus has increased its local call resale base by 103,000 while reducing its HFC local telephony customers by 28,000 and increased its broadband DSL resale base by 224,000 while growing its HFC broadband base by only 150,000.

[31] Citigroup report, 14 March 2006: "*Interestingly, despite operating its own FTTN (fibre network) in the ACT, TransACT is arguing a pro-regulation argument for ULL and is continuing to use Telstar's ULL product rather than extending the reach of its own network. This suggests the current ULL pricing is financially more attractive than extending the reach of FTTN.*"

had a negative impact on investment." In the Position Paper the Commission states that it does not consider the fact "*that competitors appear to be basing their business on access to Telstra's services rather than building their own facilities*" as indicating "*a problem with the stepping stone model. Rather the Commission considers it reflects competitors' concerns over the level of ULL access prices...*". By this the Commission is inferring that ULL prices are too high. Through some inverted logic it is trying to blame Telstra for the failure of its model. ULL prices are too low (and getting lower despite increases in input costs) not too high – resulting in market participants using ULL rather than using/building their own networks. It is much easier to join those taking from Telstra at below cost rather than to try to compete with them.

In addition to the once-we-were-competing-infrastructure-builders the Commission's approach has also spawned a plethora of other types of ULL builders - these ULL builders are, in the main, niche market players, without national coverage and without substantial customer bases. Is this the type of participant that the stepping-stone model is supposed to target?

A Citigroup report dated 7 July 2006, entitled "*In the Loop, Issue 2: Broadband Supply Side Dynamics*" describes a study of the 300 most profitable local exchanges in Australia and in the words of Citigroup "*the study provides some interesting (and scary) conclusions*". Citigroup, as do our earlier submissions[32], highlight the extent of overcrowding in local exchanges with a substantial number of exchanges with four or five co-located operators fighting for only 2000-3000 households per operator. Citigroup point to the fact that:

> "The overcrowding is even more acute with reports from Ericsson and British Telecom claiming it is only possible to provide ADSL2+ to 50% of exchange lines or face significant cross talk issues (which degrades the speed and quality of a broadband service)."

But perhaps the scariest of all is that Citigroup reports that from their discussions with industry sources, this analysis has not been undertaken by other operators. Who goes into business without examining the simple dynamics of supply and demand? When you have the Commission holding your hand, perhaps you do not feel the need.[33]

The Citigroup analysis shows how market inexperience, egged on by the Commission's signals on ULL prices, has led a number of small market participants to become entangled in a web of infrastructure overbuild. This is likely to end in ruin.[34] Like night follows day, when the

---

[32] See Attachment A of Telstra's response to the Commission Proposal – "A Strategic Review of the regulation of fixed network services", February 2006 and pages 19 and 20 of Telstra's response to the Local Services Review, April 2006.

[33] For example, speculation arose if Telstra proceeded with its FTTN network rollout, the Commission would have ensured that ULL providers were given compensation – this despite the fact that Telstra generally has a clear right in its supply contracts to terminate supply of a product on6 month's notice, see Macquarie Equities Research Report, Telstra Corporation Under Construction...except FTTN, dated 11 July 2006.

[34] Citigroup also point to the fact that these players can't even get out of their woes through market consolidation as the extent of overbuild is so great – pages 7 and 8, 7 July 2006. Grahame Lynch has made similar observations:

> "*Perhaps that's the idea: squeeze all the value out of telecom investment by perversely distorting incentives across the board. Wipe billions of dollars off Telstra, spur a bubble that ultimately hurts competitive carriers, and while*

Australian ULL builders start filing for insolvency the Commission will find some way to lay the blame for **its policies** at Telstra's door.

6. No xDSL declaration

The Commission introduces Chapter 7 of the Commission's Position Paper as stating:

> "...at this stage, the Commission's thinking has not sufficiently progressed to undertake a full LTIE analysis of declaration of a particular service. ... This section of the draft response is therefore necessarily limited in scope. The Commission's comments are limited to the identification of some issues in relation to the potential application of Part XIC to DSL services.[35]"

From this statement Telstra understands that the Commission does not, at this stage, intend to undertake a formal review of whether a declaration in relation wholesale DSL services would be in the LTIE. If the Commission's thinking changes, then Telstra requests formal notice from the Commission. In this regard, Telstra's comments are limited to the identification of some issues in relation to why the potential application of Part XIC is not appropriate to DSL services.

Telstra has outlined above a methodology for the Commission to follow to approach deregulation of the Australian telecommunications market. An approach that is internationally recognised and supported. We provide the Commission with an outline of how that analysis can be applied in practice to the question of declaration of xDSL services.

Do access seekers have access to services at a level higher in the network?

Yes, ULL and the Spectrum Sharing Service.

Does the downstream market have the potential for competition on a forward looking basis?

In the words of the Commission "*it seems plausible Telstra's wholesale market power could be undermined over the coming years*"[36]. If the Commission used facts and figures, such as those that could be obtained through an infrastructure audit, it would see not only a landscape of competing ULL providers, it would find, such as Citigroup did, an oversupply of such infrastructure in many places.

Moreover, the retail broadband market in Australia is already overwhelmingly competitive with many market participants using their own, or Telstra's, or third party infrastructure to provide a plethora of competing offers and packages. There is competitive tension between providers of ADSL, ADSL 2+, BDSL, cable, fibre, wireless and mobile providers both to end users and to intermediary ISPs. Consumers and businesses are faced with a myriad of supplier and pricing

---

you're at it, undermine the incentives for competing HFC and wireless infrastructure. At least everyone gets equality of sort!", page 5 Communications Day, 15 August 2006.

[35] Page 82.

[36] At page 90 of the Position Paper.

options. It is not clear what declaration would achieve in these conditions apart from the chilling of investment and regulatory error.

What about those areas where ULL is not utilised by competitors?

Firstly, are those areas bottleneck areas? Are alternate network available, such as wireless networks? What impact will the Government's Broadband Connect initiative have? Is the threat of entry a sufficient constraint?

Even if Telstra's network is the only alternative, are access seekers able to access wholesale services on the basis of equivalence?

Yes. The principles of the Operational Separation regime have seen to that.

Is the Commission's use of its XIB and section 46 powers sufficient to constrain Telstra's conduct?

Yes. The Commission's powers under Part XIB and section 46 are extensive.

Would the risk from declaration outweigh any benefit and dampen the incentive for further infrastructure investment, both fixed and wireless?

Yes. A declaration of DSL services would affect all providers of these services. As Telstra's recent decision not to proceed with its FTTN investment shows, the spectre of cost based Part XIC regulation has a deadening effect on investment.

The Commission seems to have come to same conclusion but on a different basis. Page 93 of the Position Paper states:

> "...the case for declaration is not currently overwhelming – particularly in light of the relatively sparse submission that were received on this issue. ...
>
> The Commission believes that there is some further scope to consider these issues in the future, and seeks comment on the analysis presented in this chapter to further its understanding of the effect any declaration could reasonably be expected to have on the LTIE."

These statements from the Commission give the impression that the Commission would be minded to reconsider its position if it received submissions with contrary views. Telstra hopes that this impression is misguided and that Commission would only change its view if it was in possession of up-to-date facts and figures and a comprehensive fact-based review of the market which illustrated systematic problems with access to wholesale DSL services, which on a forward looking basis, could ***only*** be resolved through a declaration of the service, rather than through the use of the Commission's extensive powers under Part XIB and section 46 of the Act.

Telstra Corporation Limited

31 August 2006

Attachment A - The "Ladder of investment" revisited[37]

"...a great potential harm to welfare occurs when replication is feasible but not promoted"
European Regulators Group, 2004

Summary

The "ladder of investment" refers to the idea that entrants in telecommunications markets need one or more levels of access to existing platforms in order to acquire customers and build scale, ultimately allowing them to become sufficiently profitable to invest in infrastructure build-out – thereby climbing the "ladder of investment".

In competitive markets a ladder is not necessary for entrants to establish themselves and build or lease competing infrastructure. In addition, there is no rigorous theoretical underpinning to the notion that a "ladder of investment" is necessary.

In a regulatory context it is not possible to achieve the correct pricing signals and relativities for various wholesale products along the value chain and to adjust these in response to actual and anticipated technological and market changes. The notion of a "ladder of investment" is therefore likely to prove unworkable in practice, and investment, innovation and infrastructure competition would be expected to suffer.

In the US the "ladder of investment" approach has been largely abandoned with removal of requirements to provide unbundled access in voice and broadband markets during 2004 and 2005.

In Europe one of the original authors of the concept, Professor Martin Cave, has more recently argued that: *"[the regulator should choose] the point on the ladder at which the intervention should still be applied... with a bias in favour of those more advanced in their infrastructure buildings."*

In the UK the regulator Ofcom has stated that: *"the regulator's job is not to create short-term arbitrage opportunities for alternative businesses, but to encourage sustainable competition at the deepest points of interconnection."*

We propose that the ladder concept be progressively replaced by access at a single point where bottlenecks occur, private negotiated terms of access are an inadequate solution and competition law remedies are not sufficient. The point of access may differ in different locations, for example, in urban areas Unbundled Local Loops (ULL) may be appropriate while in an urban area ULL may prove uneconomic and bitstream may be more appropriate.

[37] Appendix to "Restoring European economic and social progress: unleashing the potential of ICT", a report by Indepen for the Brussels Round Table of leading European telecommunications operators and equipment manufacturers: Brian Williamson, Phillipa Marks, David Lewin, Justine Bond and Helen Lay.

Discussion

Underlying the "ladder of investment" theory is a view that regulators may no longer need to choose between the short and the long run – between policies that emphasize static efficiency and those that give preference to dynamic efficiency - because the two can be reconciled via the "ladder of investment". The "ladder of investment" theory is therefore important – if it holds, a key trade-off might be overcome, if not, then regulators must confront a trade-off in their choice of policies.

In Recital 19 of the Access and Interconnect Directive (2001/19/EC) it states that:

> *"the imposition by national regulatory authorities of mandated access that increases competition in the short-term should not reduce incentives for competitors to invest in alternative facilities that will secure more competition in the long-term."*

The European Regulators' Group (ERG) recognises that a trade-off may be involved:[38]

> *"There is general agreement that a great potential harm to welfare occurs when replication is feasible but not promoted. This will delay the roll out of new and innovative services and, particularly in relation to broadband, may have large negative consequences on the general economy." (ERG Common Position on Remedies, page 67)*

However, in another paper which considers the application of the ladder of investment concept to broadband markets, the ERG argues that countries with a complete set of broadband access products available to the new entrant (resale, extreme access, shared access and full unbundling) tend to be more competitive than those where products (or the rungs of the ladder of investment) are missing, and that such competition leads to higher broadband penetration. [39]

In fact, the evidence presented to support this conclusion by the ERG on the availability of wholesale access products, does not support the conclusion. In particular:

- The two countries from the 13 surveyed with the highest penetration levels, Switzerland (18.5 per cent) and the Netherlands (18.9 per cent), have the least complete investment ladders for broadband

- The two countries with the most complete investment ladders, Spain and the UK, have below average broadband penetrations levels at 10.5 per cent and 8.5 per cent respectively (average broadband penetration for the 13 surveyed countries was 11.1 per cent)

---

[38] ERG. April 2004. "ERG Common Position on the approach to Appropriate remedies in the new regulatory framework."

[39] ERG. May 2005. "Broadband Market Competition Report" ERG(05)23. http://erg.eu.int/doc/publications/erg_05_23_broadbd_mrkt_comp_report_p.pdf

The fact that success in implementing the ladder of investment depends on regulators achieving the correct pricing signals and relativities for the various wholesale products means that the application of the concept will involve errors – errors that are likely to harm the emergence of platform competition and real innovation in terms of services and applications. There are two reasons for this conclusion. First, the task of managing margins all the way along the value chain centrally is infeasible. Secondly, once arbitrage-based competition is introduced based on regulated margins there will be strong pressure to maintain those margins.

Internationally experience and academic analysis of the concept of the "ladder of investment" also points to a conclusion that it is not a helpful concept. In a review of outcomes under the "ladder of investment" or "stepping stone" approach Jerry Hausman and Gregory Sidak (November 2004) conclude:[40]

> *"Telecommunications regulators offered four major rationales for mandatory unbundling: (1) competition in the form of lower prices and greater innovation in retail markets is desirable, (2) competition in retail markets cannot be achieved with mandatory unbundling, (3) mandatory unbundling enables future facilities-based investment ('stepping-stone' or 'ladder of investment' hypothesis), and (4) competition in wholesale access markets is desirable.*
>
> *An empirical review of the unbundling experience in United States, the United Kingdom, New Zealand, Canada, and Germany suggests that none of the four rationales is supported in practice. Rationales (2) and (4) were incorrect in theory and therefore had little or no chance of succeeding in practice. By contrast, the stepping stone hypothesis and lower retail prices were theoretically plausible under certain assumptions yet were not satisfied in practice."*

US experience

The notion of a "ladder of investment" parallels the notion of "stepping stones" to competition in the US, where it has, to a significant extent, been abandoned in a series of decisions by the FCC.[41] In particular, the FCC, following the Triennial Review Order of 2003 and the review of Section 251 unbundling obligations of December 2004, together with the findings from a court case on the Triennial Review Order, has ruled that:

- There is no requirement for a carrier to supply unbundled elements from its fibre to the home or fibre to the kerb facilities
- ILECs are no longer obliged to supply UNE-P offerings.

Further, the FCC decided in August 2005 to place Digital Subscriber Line (DSL) technology on an equal regulatory footing with cable modem service, consistent with a US Supreme Court decision

---

[40] Jerry Hausman and Gregory Sidak. November 2004. "Did Mandatory Unbundling Achieve Its Purpose? Empirical Evidence from Five Countries." Massachusetts Institute of Technology Department of Economics Working Paper 04-40. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=623221

upholding the Commission's light regulatory treatment of cable modem service. Specifically the FCC noted that:[42]

> *"Today, the Commission eliminated this transmission component sharing requirement, created over the past three decades under very different technological and market conditions, finding it caused vendors to delay development and deployment of innovations to consumers."*

In setting out the detailed reasoning for the decision to phase out unbundling of DSL. the FCC noted:[43]

> *"...the characteristics of the broadband market, as well as evidence that facilities-based wireline carriers have incentives to make, and indeed already make, broadband transmission capacity available to ISPs, absent regulation, are factors that influence our analysis in determining whether such regulation is still necessary. Moreover, this regulation can have a significant impact on the ability of wireline platform providers to develop and deploy innovative broadband capabilities that respond to market demands. The record shows that the additional costs of an access mandate diminish a carrier's incentive and ability to invest in and deploy broadband infrastructure investment." Paragraph 44.*

European experience

The notion of a "ladder of investment" was originally set out in a number of papers in Europe,[44] but does not appear to have any rigorous theoretical underpinnings in the telecommunications or industrial organisation literature. The idea certainly seems at odds with experience in competitive markets where no ladder is required for new entry to occur provided provision is made for access to non-replicable essential facilities, for example, the runway in the civil aviation industry.

More recently Martin Cave, in a commentary on making the ladder of investment operational for Deutsche Telekom, noted that:[45]

> *"[the regulator should choose] the point on the ladder at which the intervention should still be applied. This decision will be based on an analysis of the scale and prospects of the operators at various points, with a bias in favour of those more advanced in their infrastructure buildings." Page 24*

---

[41] Nuechterlein and Weiser. 2005. "Digital crossroads – American telecommunications policy in the internet age." The MIT Press.
[42] FCC. 5 August 2005. "FCC Eliminates Mandated Sharing Requirement on Incumbents' Wireline Broadband Internet Access Services." http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-260433A1.pdf
[43] FCC. 23 September 2005. "Appropriate framework for broadband access to the internet over wireline facilities." FCC 05-150.
[44] Martin Cave & Ingo Vogelsang. November/December 2003. "How access pricing and entry interact". *Telecommunications Policy*, Volume 27(10-11), 717-727.
[45] Martin Cave. November 2004. "Making the ladder of investment operational." Page 29.

"The paper has emphasised, however, that this [the ladder of investment] is not an argument for providing access at low prices on a carte blanche basis. Instead the proper approach seeks to restrict mandatory access to a limited period – after which it ceases to be available, or becomes subject to commercial agreement, or rises in the regulated price." Page 29

"In order to apply the ladder approach rigorously it is necessary first to establish which assets are replicable, which are non-replicable and which are in an intermediate position....It should be remembered, however, that non-replication may arise as a result of too generous access arrangements. In other words the risk of a 'false negative' must be considered..." Page 29

"This rigorous approach is necessary to prevent implementation of the 'ladder' approach relapsing into a policy of 'easy access', thereby denying consumers the benefits of infrastructure competition." Page 30

To summarise, where assets are found to be non-replicable a single rung on the ladder is proposed in terms of access.

In the UK the focus during the Ofcom strategic review of telecommunications has been on rationalising layers of access. The various consultation documents during the Ofcom Strategic Review of Telecommunications do not refer to the "ladder of investment" at all. In the Phase 2 consultation Ofcom identifies five principles to guide Ofcom's actions including:

"promote competition at the deepest levels of infrastructure where it will be effective and sustainable" Paragraph 1.25

Ofcom also noted in the Phase 2 consultation document:

"At the moment there is regulation in many retail markets, as well as a complex mesh of regulation at different wholesale levels, illustrated in Figure 1." Paragraph 1.41.

Ofcom's Chief Executive, Stephen Carter, set out the Ofcom approach at a Consultation Seminar on the Strategic Review on 26 January 2005 to the Westminster eForum:[46]

"... the regulator's job is not to create short-term arbitrage opportunities for alternative businesses, but to encourage sustainable competition at the deepest points of interconnection with the BT network- that is, true facilities-based competition which allows a wide range of innovation and differentiation in the retail and service markets."

In a review of the pros and cons of antitrust in deregulated markets published by the Swedish Competition Authority, Oldale and Padilla (2004) carefully scrutinise the "ladder of investment" argument and conclude that it does not allow regulators to side-step the trade-off between short-term and long-term objectives.

---

[46] Stephen Carter (Ofcom). 26 January 2005. Address to the Westminster eForum. http://www.ofcom.org.uk/media/speeches/2005/01/eforum_cs

Oldale and Padilla compare the "ladder of investment" theory to the now discredited notion from trade theory in the 1970' of "infant industry protection". The following extracts from their paper summarise the reasons for their conclusion:

> *"The "ladder of investment" theory places on regulators a heavy responsibility – not only must they act to make sure that consumers are protected in the short term, but they must also manage the evolution of market structure. This would be a challenge even in a well-understood and stable industry. And even more so in industries, such as the electronic communications industry, that are neither well understood nor stable." Page 71.*[47]
>
> *"... is it reasonable to expect that entrants offering relatively undifferentiated services succeed in the marketplace, accumulating the rents that could allow them to develop their own networks? Is it possible to reconcile market fragmentation with sustained investment and innovation? The answer to both questions appears to be a qualified no." Pages 74-75*

In other words such competition is unsustainable without perpetual regulation of access prices at investment chilling levels.

Another paper that has appraised the "ladder of investment" arguments, this time in an emerging markets context, was published by OPTA in 2005. The paper concludes that:[48]

> *"There are a number of objections to this idea. In particular:*
>
> - *There are major problems in setting supply conditions along the ladder so that there are sufficient incentives for entrants to climb from one rung to the next. So there is a danger that, as a result of regulatory error, the industry becomes stuck in a state of service based competition*
> - *There is limited empirical evidence to show that this ladder of investment process works. In the USA, where it was first implemented, most CLECs have ended up using simple resale and few have migrated to local loop unbundling. In the Netherlands, there is some evidence that certain types of dynamic access regulation have provided incentives for further infrastructure roll-out. But this was based on a simple two run ladder."*

[47] Alison Oldale and A. Jorge Padilla. 2004. "From state monopoly to the "investment ladder": competition policy and the NRF." In "The Pros and Cons of Antitrust in Deregulated Markets", Konkurrensverket, Swedish Competition Authority. http://www.kkv.se/bestall/pdf/rap_pros_and_cons_Deregulated_markets.pdf

[48] OPTA. April 2005. "Regulating emerging markets?" Economic Policy Note, no 5. Page 20. http://www.opta.nl/download/Emerging_Markets_EPN_uk.pdf

Attachment B – Commission's decisions lowering the ULL price

Table 1: ULLS Regulatory Timeline

Date	Event	Telstra Band 2 Price	Commission Band 2 Price
Aug-99	ULLS Declared		
Aug-00	Pricing Principles - Discussion Paper	$63.25	
Mar-02	Pricing Principles - Final Report (for 2000/02 prices)		$35.17
Jan-03	Telstra's Undertaking Lodged	$40.00	
Oct-03	Model Terms and Conditions - Final Determination		$22.00 +/- max $6 adjustment for demand
Nov-03	Telstra's Revised Undertaking Lodged	$22.00 + adjustment	
Oct-04	Draft Decision (for 03/04, 04/05 and 05/06 prices)		$22.00 (no adjustment)
Dec-04	ULLS Undertaking Lodged	$22.00 (no adjustment)	
Aug-05	Draft Decision (for 04/05 and 05/06 prices)		$13.00 (Estimate)
Dec-05	Final Decision		$13.00 (Estimate)
Dec-05	Telstra's revised undertaking lodged following the retail price parity obligation	$30.00 (averaged across bands)	
Apr-06	Interim Determinations		$22.00
Jun-06	Second Interim Determinations		$17.70

In October 2003, the Commission published model prices at $22 per service per month in Band 2 areas which included an adjustment mechanism of +/- $6 (maximum) if forecast demand for ULLS was under or over achieved. Telstra responded by lodging revised undertakings at the Commission's model prices with the Commission's adjustment mechanism to ensure that, whatever demand eventuated, costs would not be under or over recovered. In October 2004 the Commission rejected the ULLS prices on the basis that the adjustment mechanism was unreasonable and it again published the same indicative prices for ULLS at $22 in Band 2 areas. At that time and until 30 June 2006,the period of the Commission' s model prices, volumes for ULLS were well short of those originally forecast by the Commission – thus the $22 Band 2 price would have been much higher had the adjustment mechanism remained. So Telstra again lodged undertakings, at the Commission's indicative prices but without the adjustment mechanism. In August 2005, the Commission published its draft decision, stating that the pricing of ULLS should

be considerably lower, on the basis of its changed opinion that the cost base should be spread across a wider range of services. This was confirmed in December 2005.

So despite Telstra submitting ULLS undertakings with mirrored the prices in the Commission's own Model Terms and Conditions. Despite replicating the Commission's model prices, Telstra's undertakings were rejected. Yet the Commission has blamed Telstra for the inconsistency and uncertainty regarding ULLS pricing. For example, Graeme Samuel recently commented:

> "Telstra has lodged 4 sets of undertakings for the ULLS since 2003, and withdrawn 2 prior to a final decision being made. These 2 undertakings were then revised, submitted and withdrawn again. You might think that there is a simple reason for this – that is, the ACCC keeps rejecting those undertakings!
>
> But there are broader implications of the fact that Telstra has not submitted a reasonable ULLS undertaking to the ACCC."[49]

In December 2005, in response to the Government making its policy of retail pricing parity explicit – through the Price Control Determination – Telstra submitted an averaged ULL undertaking. Telstra's competitors disputed Telstra's undertaking prices and the Commission issued Interim Determinations at $22 for Band 2 (rejecting Telstra's averaged approach) in April 2006 and then issued subsequent Interim Determinations for Band 2 at $17.70 in June 2006. The Commission formally rejected Telstra's averaged undertakings on 25 August 2006.

---

[49] *"Regulatory Requirements for a Post-Privatised Telecommunications Market"*, a paper presented at the Australian Telecommunications Summit 2006, 24 July 2006, at pp4-5