

# Transmission Capacity Service

## Telstra's response to the ACCC's Discussion Paper reviewing the declaration for the domestic transmission capacity service

### 1 Executive Summary

There have been significant competitive developments since the transmission capacity service was first deemed as a declared service in 1997. Telstra therefore welcomes the opportunity to provide a response to the Australian Competition and Consumer Commission (the "Commission") in regard to its recent discussion paper on the declaration of transmission.<sup>1</sup>

Telstra faces strong competitive pressure in the provision of transmission services in Australia. The competitive nature of the supply of transmission is evident from consideration of a range of factors.

Firstly, as is described in detail in the main body of this submission, there is strong existing competition from alternative infrastructure providers in all but a limited number of regional areas. There are:

- six companies with inter-capital transmission infrastructure;
- a range of competing networks on regional-to-capital routes, including inter-capital network providers who have spurs into adjacent regional areas;
- state utilities who make use of their existing infrastructure network to provide transmission;
- regional microwave operators; and
- a number of infrastructure providers who offer CBD, metro and intra-regional transmission.

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<sup>1</sup> ACCC (2003), *"Transmission Capacity Service. An ACCC Discussion Paper reviewing the declaration for the domestic transmission capacity service"*

Secondly, other than perhaps on the thin regional routes which are often uneconomic, there are no substantial structural barriers to the development of competition for transmission services. Wholesale transmission services can be supplied by deploying competitive fibre infrastructure, by purchasing dark fibre or by securing bulk capacity on existing infrastructure. Although investment in equipment is required when using bulk capacity and dark fibre, this equipment is very scaleable, can be re-located should demand patterns change and the investment required is small compared to the costs of deploying network infrastructure. Thus Telstra does not believe that the equipment investment represents a significant sunk cost and therefore concludes that barriers to entry via dark fibre and bulk capacity are low, where access to dark fibre and bulk capacity is available.

Entry through deployment of network infrastructure requires a significant upfront investment; however, there are a number of factors that reduce the risk associated with earning an appropriate return on the investment. These include the strong rate of growth in demand, the use of long-term contracts (reducing investment risk) and the density of customers in CBD and metropolitan areas. In respect of tail-end transmission, another factor that facilitates entry is the availability of ULLS. Entrants can use ULLS with DSL equipment to provide transmission tail-ends with speeds of 2Mbit/s and potentially higher, depending on the location of the customer and whether symmetric bit rates are required.

There are some transmission services, such as inter-capital transmission, for which it is unlikely that significant new network-based entry will occur in the short to medium term due to the extensive entry that has already taken place. However, Telstra does not view this as a barrier to the development of competition. Rather, the large amount of existing competitive network infrastructure on inter-capital routes will itself sustain intense competition on those routes.

Thirdly, any suggestion that suppliers enjoyed market power in supplying transmission would be mistaken given that market power could not be taken advantage of due to the countervailing market power of buyers.

Finally, market outcomes support the conclusion that there is strong competitive pressure on transmission suppliers. There have been significant reductions in prices for wholesale transmission, including reductions in prices on inter-capital routes post declaration revocation. There have also been price reductions in the relevant downstream services. Consistent with this competitive picture, there have been no recent transmission pricing arbitrations.

Given the extent of competition, it is inappropriate for transmission services to be declared. Declaration will, due to regulatory risk, distort efficient incentives to invest and innovate. Thus, Telstra submits that inter-capital routes should continue to be unregulated and declaration should be revoked on the remaining transmission services, thereby boosting

competition as existing suppliers face appropriate incentives to invest and innovate, and new entrants face efficient build-buy incentives.

The remainder of this submission is structured as follows:

- Section 2 details the competitive landscape by examining the entry that has occurred to date, the structural factors affecting the development of competition and the extent of countervailing buyer power and market outcomes.
- Section 3 discusses the consequences of the findings of Section 2 for the assessment of whether continued declaration of transmission services is required, and whether inter-capital transmission should continue to be exempt from any extension of the declaration.

## **2 Competitive Landscape**

The material presented in this section shows that Telstra faces a broad range of competitors, including some who primarily supply transmission to their own downstream operations, and others who offer wholesale transmission services to other parties. The observed entry reflects the fact that, with the possible exception of the thin regional routes which are often uneconomic, competition for transmission services is not hindered by the presence of entry barriers. Rather, the market structure indicates that firms have strong incentives to compete vigorously in the supply of transmission services. The price falls that have occurred for transmission services, and for the downstream services that use transmission as an input, are consistent with this conclusion.

### **2.1 Competitors**

Telstra has a range of well-financed and internationally backed competitors who provide competing transmission services. In providing wholesale transmission services, some suppliers rely primarily on their own infrastructure (such as Telstra and Optus), some rely on a mix of purchased capacity and their own infrastructure (for example AAPT and PowerTel), and others (for example Comindico) rely purely on infrastructure owned by other carriers.

Table 1 shows the number of alternative infrastructure transmission providers on inter-capital routes, excluding the satellite providers (Bareena Holdings and PanAmSat Asia) who offer services Australia-wide. On all routes, there are at least two competing infrastructure providers. On the East-West routes there are four competing infrastructure suppliers after the acquisition of IP1 by Telstra. On routes between Melbourne, Sydney and Brisbane, there are up to 6 competing infrastructure suppliers.

Table 1 underestimates the number of competitors supplying transmission, as there are a number of dark fibre and bulk capacity deals that allow additional competitors to supply wholesale transmission services. In addition, when analysing competition on routes it is important to recognise all relevant substitutes, including indirect routings, which provide competitive constraints. For example, international traffic routed to Melbourne via SEA-ME-WE-3, (an international cable linking Perth to Europe and Asia via Indonesia) and the Perth to Melbourne terrestrial transmission links, can be re-routed to cables landing on the east coast of Australia. This serves to apply further competitive pressure on the Perth to Melbourne transmission link.

**Table 1: Competing inter-capital transmission infrastructure**

Supplier /# of Suppliers	Adelaide	Brisbane	Canberra	Melbourne	Perth	Sydney
Adelaide		NextGen Optus Telstra	Optus Telstra	Nextgen Optus Telstra SPT	NextGen Optus Telstra SPT	NextGen Optus Telstra
Brisbane	3		Optus Telstra PowerTel NextGen	NextGen Optus Telstra PowerTel Flow	NextGen Optus Telstra	NextGen Optus Telstra PowerTel SPT
Canberra	2	4		Optus Telstra Flow PowerTel NextGen	Optus Telstra	Optus Telstra Flow PowerTel NextGen
Melbourne	4	4	5		NextGen Optus Telstra SPT	NextGen Optus Telstra PowerTel SPT Flow
Perth	4	3	2	4		NextGen Optus Telstra
Sydney	3	5	5	6	3	

Source: ACCC (2003) "Telecommunications Infrastructure in Australia 2002" updated with information from companies' websites.

The wide range of competing infrastructure operators is not limited to inter-capital routes. **Table 2** outlines the competing infrastructure on a number of backbone regional to capital routes. The competing networks fall broadly into three categories:

- inter-capital network providers who have spurs into the regional areas adjacent to the inter-capital routes (for example Optus, Powertel, and Flow);
- state utilities who utilise their existing infrastructure network to provide transmission (for example Queensland Reef Network, Vic Track, Powercor) ; and

- regional microwave operators (for example Datafast, ntl Australia, Telecasters Australia) .

This table underestimates the supply of transmission capacity on capital to regional routes as it does not include the in-place fibre infrastructure of Nextgen. Nextgen's 8,400km national optical fibre network cable was planned to provide connectivity to approximately 70 major and regional population centres, equivalent to approximately 90% of Australia's population<sup>2</sup>. It has Fibre Access Points established at regional towns passed by the cable route. These Fibre Access Points are ready for deployment to supply transmission capacity when required. Table 3 shows examples of towns passed by Nextgen's network. The acquirer of Nextgen's network would be well placed to provide transmission capacity to regional areas.

There are also a number of alternative infrastructure providers in CBD, metropolitan and regional areas. These providers self-supply transmission (including tail-end and inter-exchange transmission) and in some cases offer wholesale transmission services to other parties. Table 4 sets out Telstra's competitors and their competing local infrastructure. The table shows that in CBDs, metropolitan areas and some regional areas Telstra faces strong competition from infrastructure providers. As well as Telstra's well-established competitors Optus and AAPT, there is a range of second tier players including MCT, MCI, PowerTel and Primus, all of whom own significant infrastructure. In addition to these second tier players, there are at least another 19 infrastructure owners providing services in a variety of geographic areas.

A number of strategic alliances have developed between infrastructure players, strengthening their ability to compete effectively. For example there is an agreement between PowerTel and Uecomm to link Uecomm's metropolitan networks in Melbourne, Sydney and Brisbane via PowerTel's inter-state network. Uecomm also has strategic alliances with the DSL providers Nextep and Request. Powertel has a strategic alliance with MCT under which MCT migrates traffic to PowerTel's network, thereby reducing MCT's backbone capacity costs and boosting PowerTel's network usage and revenues.

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<sup>2</sup> Nextgen website [www.nextgennetworks.com.au](http://www.nextgennetworks.com.au)

**Table 2: Competing infrastructure on backbone capital to regional routes**

From	To	Telstra	Optus	Powertel	Flow (Macrocom)	AAPT	ntl	Others
Sydney	Albury	✓	✓	✓			✓	
Sydney	Armidale	✓	✓	✓	✓		✓	SPT Microwave (Joint venture with ntl)
Sydney	Goulbourn	✓	✓	✓	✓		(uc)	
Sydney	Lismore	✓	✓		✓		(uc)	SPT Microwave (joint venture with ntl)
Sydney	Newcastle	✓		✓			✓	
Sydney	Orange	✓	✓	✓	✓		(uc)	
Melbourne	Ballarat	✓	✓	✓	✓	✓	✓	Datafast; VicTrack, Powercor, Neighborhood Cable
Melbourne	Geelong	✓	✓			✓	✓	VicTrack, Powercor, Neighborhood Cable
Melbourne	Bendigo	✓	✓	✓	✓	✓	✓	Datafast, VicTrack, Powercor
Melbourne	Mildura	✓	✓		✓		(uc)	
Melbourne	Morwell	✓	✓		✓			VicTrack
Melbourne	Wangaratta	✓	✓	✓				
Brisbane	Maryborough	✓	✓				✓	
Brisbane	Cairns	✓					✓	Queensland Reef Network Telecasters Australia
Brisbane	Rockhampton	✓	✓				✓	Telecasters Australia
Brisbane	Toowoomba	✓	✓	✓			✓	Telecasters Australia
Brisbane	Townsville	✓	✓					Telecasters Australia
Perth	Bunbury	✓	✓	✓				
Perth	Kalgoorlie	✓	✓	✓				Amcom
Perth	Katanning	✓	✓	✓				Amcom
Adelaide	Gawler	✓	✓	✓		✓		Agile
Adelaide	Mt Gambier	✓	✓	✓				Agile
Adelaide	Murray Bridge	✓	✓	✓				Agile
Adelaide	Port Augusta	✓	✓	✓				Agile

(uc) =under construction

Source: ACCC (2003) "Telecommunications Infrastructure in Australia 2002" updated with information from companies' websites.

**Table 3: Examples of regional towns passed by Nextgen’s national optical fibre network**

Sydney to Brisbane (Main) Route		Sydney to Brisbane (Diverse) Route	
Newcastle	Grafton	Young	Moree
Taree	Lismore	Parkes	Goondiwindi
Coffs Harbour	Tweed Heads	Dubbo	Toowoomba
		Narrabri	Ipswich
Melbourne to Sydney (Main route)		Melbourne to Sydney (Diverse route)	
Albury	Canberra	Bendigo	Young
	Wollongong		
Melbourne to Adelaide Route		Adelaide to Perth Route	
Geelong		Port Augusta	
Ballarat		Kalgoolie	

Source: Nextgen website <http://www.nextgennetworks.com.au/>



**Table 4: Telstra’s competitors and their local network infrastructure**

<b>Company</b>	<b>Technology type</b>	<b>CBD</b>	<b>Metro</b>	<b>Regional / Rural</b>	<b>Network coverage description</b>
<b>Optus</b>	Optic Fibre	✓			Covers Launceston and 8 CBDs: Sydney, Melbourne, Brisbane, Canberra, Adelaide, Perth, Darwin and Hobart.
	HFC		✓		Metro and Urban areas in Sydney, Melbourne and Brisbane.
	LMDS	✓			CBD areas (where complimentary to its DSL and fibre coverage) in Sydney, Melbourne, Brisbane, Adelaide, Perth and Hobart
	DSL	✓	✓	✓	103 exchanges enabled to provide high-speed DSL. Its DSL network provides “comprehensive coverage of capital city and key metropolitan and regional areas of Australia.”
<b>AAPT</b>	DSL	✓	✓	✓	AAPT offers DSL services where it has rolled out 22 DSL exchanges to certain metropolitan areas of Sydney, Melbourne, Brisbane, Canberra, Adelaide Perth and selected major regional cities.
	Optic fibre	✓		✓	Over 800 kilometres of fibre optic cable in the CBD and metropolitan areas of Sydney, Melbourne, Brisbane, Adelaide, Perth, Canberra and selected major regional cities. According to its web site, it has to date connected more than 400 buildings in those locations.
	LMDS	✓	✓	✓	6 CBDs and broader metropolitan business areas (Sydney, Melbourne, Canberra, Brisbane, Adelaide and Perth), Geelong, Bendigo and Shepparton.
	Microwave	✓	✓		CBD and metro areas in Melbourne, Sydney, Brisbane, Adelaide, Perth and Canberra
<b>MCT</b>	DSL	✓			CBD areas in Melbourne and Sydney
<b>MCI</b>	Optic Fibre	✓			Sydney CBD and Melbourne CBD
<b>PowerTel</b>	Optic Fibre	✓	✓		CBDs and some metro areas – Sydney, Melbourne, Brisbane, Gold Coast

Company	Technology type	CBD	Metro	Regional / Rural	Network coverage description
Primus	Optic fibre	✓			CBDs in Melbourne and Sydney
	DSL	✓			CBDs in Melbourne and Sydney
Amcom	Optic fibre	✓	✓		(Fibertel) 4 CBDs (Adelaide, Darwin, Perth and Hobart) and three metro areas (Adelaide, Darwin, Perth)
Transact	Optic fibre	✓	✓		Canberra Metro
	DSL		✓	✓	Canberra Metro and Queenbeyan
UEComm	Optic fibre	✓	✓		CBDs and metro (Sydney, Melbourne, Brisbane, Adelaide and Perth). Have also rolled-out network in the Gold Coast.
Request	DSL		✓		Metro areas in Melbourne, Sydney, Perth, Brisbane and Adelaide
Agile	Optic fibre	✓			Adelaide CBD
	DSL	✓		✓	Adelaide CBD
	Microwave		✓	✓	Adelaide and regional areas in SA
Ipera	Optic fibre		✓		Newcastle metro
Smart radio system	Optic fibre			✓	Cooma
Swiftel	Optic fibre	✓			Perth CBD
Austar	LMDS/ MMDS	✓	✓		Adelaide, Melbourne, Sydney, Brisbane, Canberra and Perth (planning)
	HFC		✓		Darwin (Windytide)

<b>Company</b>	<b>Technology type</b>	<b>CBD</b>	<b>Metro</b>	<b>Regional / Rural</b>	<b>Network coverage description</b>
Neighborhood cable	HFC		✓	✓	Mildura, Ballarat, Geelong
Akal	LMDS/ MMDS		✓	✓	Metro areas and regional Australia (planning)
ntl Telecommunications	Microwave			✓	Providing regional access in country VIC and NSW

Source: ACCC (2003) "Telecommunications Infrastructure in Australia 2002" updated with information from companies' websites.

## 2.2 Market structure – implications for competition

This section considers the opportunity for competitor entry and expansion to occur in the supply of transmission services, and the implications for the competitiveness of transmission services.

It is typically considered that a firm cannot have substantial market power unless significant barriers to entry exist, though the mere existence of barriers to entry does not in itself imply that a firm has substantial market power. In other words, significant barriers to entry are a necessary, but not sufficient, condition for substantial market power to exist. For example, even if significant barriers to *new* entry do exist then competition between players already active in the market may constrain the incumbent and its rivals from raising price above competitive levels. Similarly, strong countervailing power may place a substantial competitive constraint on an incumbent, even when entry barriers are high.

### Factors affecting market entry

There are a number of options for entry into the supply of wholesale transmission services. Firms can enter by either:

- deploying their own network infrastructure. In the context of the provision of tail-end transmission, this could include the use of fibre, HFC, LMDS, MMDS or microwave technologies. In the context of backbone networks and inter-exchange transmission, the network is most likely to be based on either fibre or microwave technologies.
- purchasing dark fibre, either for the purposes of supplying tail-end transmission, backbone transmission, or inter-exchange transmission;
- securing bulk capacity on existing infrastructure for the purposes of supplying backbone or inter-exchange transmission; or
- using DSL technology with Telstra's ULL service. This option is relevant where a firm is looking to supply tail-end transmission.

The first option above, entry through network deployment, typically requires a significant upfront network investment. As discussed above in section 2.1, this type of entry has already occurred on inter-capital routes, on a number of the key regional-capital routes, and in the provision of inter-exchange transmission and tail-end transmission in CBD and metropolitan areas. While new network-based entry may not occur in the short-medium term for services where extensive competitive network deployment has already occurred, such as on the inter-

capital routes, this will not restrict the intensity of competition for those services. To the contrary, in respect of, say, inter-capital transmission where such extensive entry has already occurred so that the potential (unlit) capacity available substantially exceeds transmission demand, firms have strong incentives to compete vigorously.

Inter-capital routes aside, there are a number of factors that facilitate network deployment in the presence of the sunk costs on other routes where competition is still developing. First, where competitors have already deployed network infrastructure on the main routes, the incremental cost of building spurs to adjacent regional destinations can be relatively low.

Second, term contracts with infrastructure providers are common for a range of transmission services. The length of contracts reduces the uncertainty around future revenue streams, reducing the riskiness of the investment and thereby reducing barriers to entry. Table 5 illustrates some available information of transmission contract lengths. For example, Telecasters, which has not yet completed its infrastructure rollout, has already signed a 10-year contract for the supply of transmission capacity to ntl.

**Table 5: Transmission Contract Length**

Customer	Supplier	Length	Value of Contract	Comments
AAPT	Optus	15 years	\$104m	
Primus	Optus	15 years	\$70m	
PowerTel		15 years		East-West transmission capacity
ntl	Telecasters	10 years		Rockhampton to Cairns transmission capacity

Source: Company annual reports and press releases

Third, strong demand growth can mean that a significant portion of demand is effectively uncommitted and is thus potentially easier for new entrants to capture than demand that is already served by incumbent suppliers. In Telstra’s experience high demand growth has occurred on all types of transmission in all geographic areas. The high growth in demand can also facilitate entry on routes not previously targeted by competitors, by allowing entrants to achieve the economies of scale necessary to compete effectively in the market.

Fourth, in CBD and metropolitan areas the high density of customers leads to a concentration of traffic in those areas, thus lowering the unit costs of provision. There is also

a concentration of potential revenues in these areas with a large number of businesses that are heavy users of telecommunications services.

These factors all serve to facilitate the development of network-based entry in the face of sunk costs.

As discussed above, other methods of entry into the supply of transmission are through the use of leased dark fibre or bulk capacity. The barriers to this type of entry are relatively low. To provide wholesale transmission services, multiplexing equipment would be required where bulk capacity is used, and both multiplexing and line terminating equipment is required for dark fibre. This equipment is very scaleable and can be purchased incrementally to match demand, for example line cards can be purchased as and when required. This equipment can also be re-located should demand patterns change. The relative investment required to provide this equipment is small when compared to the costs of deploying competing infrastructure. Thus Telstra does not believe that this investment represents a significant sunk cost and therefore barriers to entry via dark fibre and bulk capacity are low, where dark fibre and bulk capacity are available. As noted by the Commission in its 2001 report<sup>3</sup>, there is a sale of dark fibre from SingTel Optus to AAPT. This arrangement gives AAPT exclusive access and ownership of SingTel Optus' dark fibre for approximately 25 years. Examples of bulk capacity purchases are given in table 5 of section 2.2.1 of this submission.

Finally, the availability of ULLS eases entry in the supply of tail-end transmission. Entrants can use ULLS with DSL equipment to provide transmission tail-ends with speeds of 2Mbit/s and potentially higher, depending on the location of the customer and whether symmetric bit rates are required.

### **Strategic barriers to entry**

The Commission asks the question of whether there is excess capacity of transmission, and raises the concern of whether the presence of significant excess capacity would form a barrier to entry. In particular, the Commission states that:

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<sup>3</sup> ACCC (2001), "Domestic Transmission Capacity Service. An ACCC final report examining possible variation of the service declaration for the domestic transmission capacity service", May 2001, p17

“The existence of significant excess capacity may provide a barrier to entry for new entrants, who may be hesitant to enter a market where the incumbents have the potential to engage in vigorous competition.”<sup>4</sup>

As Telstra has highlighted previously,<sup>5</sup> there are a number of different possible interpretations of what exactly “excess” capacity is. One measure of excess capacity could be based on the relativity between the actual capacity used and the total capacity that could be put through the network if all fibre was lit to its full potential. An alternative measure of excess capacity would be to consider the relativity between the actual capacity used and the total *provisioned* capacity. This would measure the “excess provisioned capacity”. Telstra submits that if what the Commission means by excess capacity is the capacity that could be readily utilised without further investment, then it is the excess provisioned capacity that is of relevance. As was discussed above, the cost of the electronic equipment (such as multiplexers) required to provision extra capacity is low relative to the cost of deploying the fibre itself and is unlikely to form an entry barrier given traffic volumes. Nonetheless, it is not costless and does represent a significant investment that is not undertaken unless it is required to meet demand. The requirement for an investment to be made to expand provisioned capacity reduces the ability for an incumbent to engage in entry deterring capacity expansion.

It is important to note that the efficient operation of a transmission network will always require unutilised capacity to provide resilience and deal with the unpredictability of demand. That is, a supplier will not normally have a 100% utilisation rate of provisioned capacity. Therefore, a calculation of the excess provisioned capacity for the purposes of assessing strategic entry barriers must account for this. For example, a supplier that has a 80% utilisation rate may only be considered to have, say, 10% spare capacity if the maximum utilisation rate that the supplier would be prepared to run its network at is 90%. In addition, as we have shown above, demand is growing and therefore the efficient investment profile will likely display some lumpy characteristics such that at any point in time there will be some unutilised capacity installed to meet future demand. This means that excess provisioned capacity is generally temporary, as opposed to the permanent excess capacity that would be required to deter entry. Telstra therefore considers it highly unlikely that incumbent suppliers of transmission would be able to engage in entry-deterring behaviour through the threat of substantially reducing prices and expanding output.

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<sup>4</sup> ACCC (2003), p20.

<sup>5</sup> See for example Telstra (2000) ‘*Telstra’s Submission to the ACCC Discussion Paper Examining Possible Variation or revocation of the Service Declaration for Transmission Capacity*’, August, p2.

More generally, Telstra notes that the proposition that an incumbent could credibly commit to a strategic post-entry reduction in price, and that it would be profitable to do so is highly questionable.<sup>6</sup> Put simply it would not be in the incumbent's interest to enter into a price war with the new entrants.

It is noted that, although there have been large price reductions for transmission services, these have not occurred as part of a course of strategic behaviour, as evidenced by the fact that price reductions have been driven by competitors and Telstra has not generally been the price leader.

Given the above, it is unsurprising that the Commission has found that since inter-capital routes were excluded from the declaration in 2001, there has been no evidence of incumbent suppliers using spare capacity to deter entry on those routes.<sup>7</sup>

### **Technological substitutes**

The Commission's interest in alternative technology may imply a belief that the availability or otherwise of alternative technologies affects barriers to entry. In particular, the Commission in its discussion paper seeks views on the technologies available to "provide substitutes for the provision of transmission services".<sup>8</sup> It then lists a number of technologies including satellite, electricity utilities' infrastructure, digital microwave and submarine cables. However, it is important not to confuse the transmission services with the underlying delivery technology. These technologies would still be providing transmission services albeit not utilising terrestrial fibre optic infrastructure.

As discussed earlier, there are a number of technologies that can be, and are, used to supply transmission. In any case, a lack of technology alternatives would not itself constitute a barrier to entry. There are no constraints on Telstra's competitors utilising fibre optic technology to compete if it is considered the most efficient technology. In many industries, including telecommunications, companies compete vigorously utilising the same technology.

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<sup>6</sup> See for example, O. Shy (1995) *Industrial Organisation*, The MIT Press, Cambridge, Mass., pages 182 and follows and P. Ghemawat (1997) *Games Businesses Play; Cases and Models*, The MIT Press, Cambridge, Mass; pages 59 and follows.

<sup>7</sup> ACCC(2003), p21.

<sup>8</sup> ACCC (2003), p17.



## 2.3 Countervailing Power

Strong countervailing buyer power adds to the competitive pressures faced by transmission providers. Transmission customers are mostly made up of large telecommunications suppliers. The nature of these customers places significant constraint on the ability of suppliers to price above a competitive level. This is because these customers:

- are individually important as a revenue source to the suppliers, and as a result competition for these customers is intense;
- given their size, resources and expertise, have the realistic option of self supply and in many instances do self-supply some transmission services; and
- are sophisticated buyers with inside knowledge of the telecommunications markets and the underlying cost of provision.

Combined, these factors mean that these customers are in a strong negotiating position when purchasing transmission services and as such would constrain any ability the supplier may have to price above the competitive level. The increasing role of Telstra's competitors in the transmission markets further strengthens the extent of countervailing power.

## 2.4 Market Outcomes

Market outcomes strongly support the conclusion of a competitive market with significant recent price falls for transmission services. Since 1998 Telstra has substantially reduced its wholesale prices on intercapital, metropolitan and backbone regional transmission. Wholesale prices continue to decline on inter-capital routes after these were exempted from declaration in 2001.

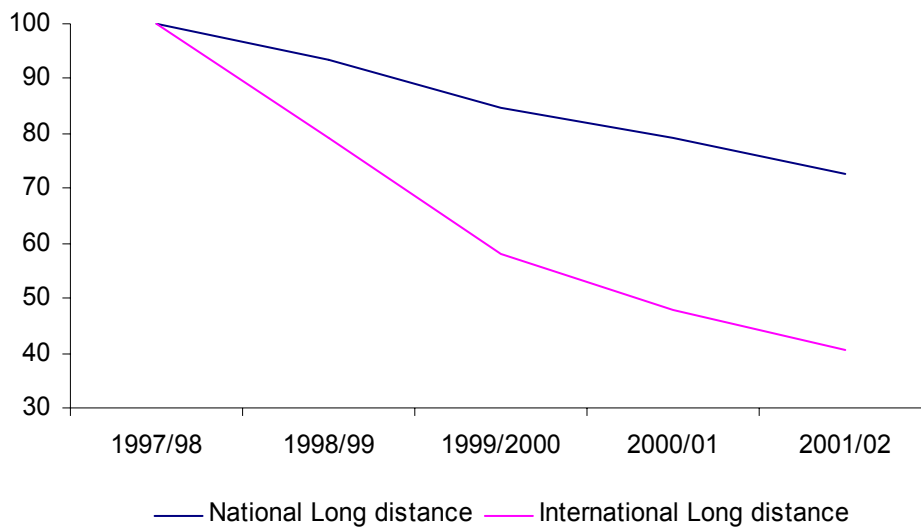
### Downstream market outcomes

The Commission suggests that the relevant downstream markets for which transmission is used as an input would likely include long distance and international call services, data related services and IP-based services. While Telstra agrees that these, with perhaps the addition of mobile services, are the relevant services that utilise wholesale transmission, it is not clear that each of these services will constitute a separate market. For example, there may be a cluster market for call services or there may not be a clear market distinction between data services and IP-based services. However, given the similar competitive nature of supply for downstream services, Telstra does not believe that it is vital to the analysis of this declaration to categorically define the boundaries of the downstream markets. There are few entry barriers to providing these services given the availability of a range of wholesale products, including regulated services (for example LCS, PSTN origination and termination,

unconditioned local loop, line sharing service, ISDN and DDAS) as well as a number of unregulated services.

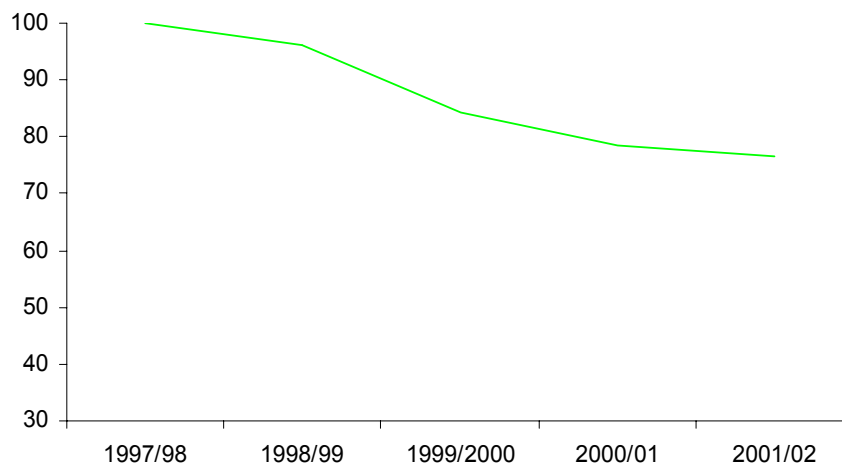
The market outcomes show that the reduction in wholesale transmission prices has been mirrored by price reductions in the downstream services. Figure 1, using ACCC analysis, illustrates the falls in long distance national and international call prices. Figure 2 shows that mobile prices, which, at least to some extent, make use of transmission, have also shown declines.

**Figure 1: Index of Long distance call prices (1997/98=100)**



Source: ACCC 2003: "Changes in prices paid for Telecommunications services in Australia 1997/98-2001/02"

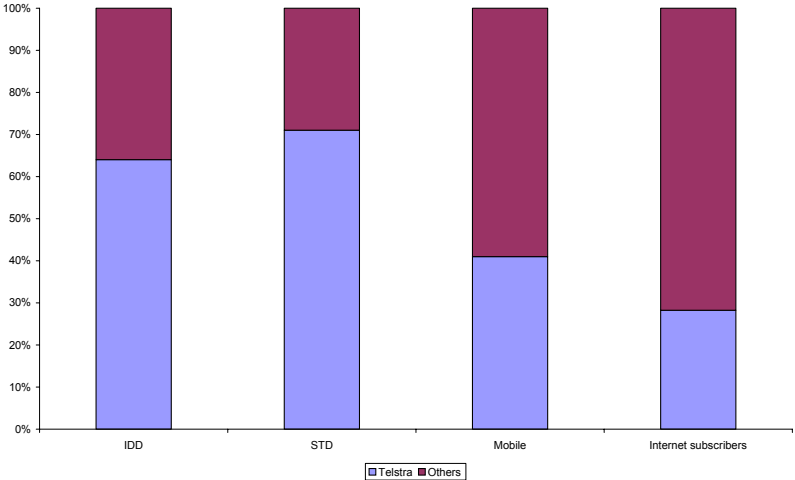
**Figure 2: Index of Mobile service prices (1997/98=100)**



Source: ACCC 2003: "Changes in prices paid for Telecommunications services in Australia 1997/98-2001/02"

The strength of competition in the downstream markets is also reflected in the size of competitors’ market shares. Although there are only limited conclusions that can be drawn from a snapshot of market shares, the significant market shares of Telstra’s competitors in the downstream markets (illustrated in Figure 3) is consistent with Telstra being under competitive constraints.

**Figure 3: Competitor shares of downstream services**



Source: IDD and STD revenue shares June 2002 source: ACCC (September 2003). “Telecommunications Market Indicator Report 2001-02”. Internet Subscriber shares March 2003, source: ABS and Telstra. Annual Reports. Mobile revenue shares for financial year 2002 source: ACCC (April 2003) “Mobile Services Review 2003”.

### 3 Appropriate regulation and pricing principles

The analysis above demonstrates that the provision of transmission services is competitive with a number of active competitors, limited barriers to the development of competition and strong countervailing buyer power. Consistent with this competitive picture, there have been no recent transmission pricing arbitrations. Given this backdrop, this section identifies the problems associated with declaration of transmission services.

The risk associated with exempting a service from regulation is that there may not be sufficient competitive constraint on the service and the unregulated price may, as a result, be set above the efficient level. However, as discussed above, existing network deployment, in

all but a small number of regional areas, and an absence of barriers to effective competition means that there are strong competitive constraints placed on suppliers of transmission services. This is consistent with the experience of inter-capital transmission post declaration revocation where transmission prices have continued to fall.

The key criteria the Commission must have regard to when deciding whether to maintain, vary or revoke declarations are:

- the promotion of competition;
- the achievement of any-to-any connectivity; and
- the encouragement of economically efficient use of, and investment in, the infrastructure by which the listed services are supplied.

Where competitive constraints are effective, declaration is unnecessary and may distort efficient investment signals. Where the price signal of a service is inaccurate, distortions will occur in the use of and investment in, the service at issue and related services. If regulation were to result in artificially low pricing for transmission then this would cause a number of distortions and inefficiencies including:

- a reduction in the incentive for competitors to build, maintain and innovate their own network infrastructure;
- a reduction in the incentives for Telstra to improve its transmission service given that there is an increased risk that an adequate return on investment will not be earned; and
- a reduction in the incentives for Telstra to innovate and invest in other wholesale services.

These distortions are not limited to the case where the regulator has set an inappropriate price. With declaration there is the risk that the prices may be set too low by the regulator in future thereby deterring investment in the current period. These concerns are not restricted to Telstra, as the Commission notes,<sup>9</sup>

*“suppliers of transmission capacity, including new potential entrants, have been worried about the impact of the Commission’s arbitration powers after declaration on their expected returns.”*

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<sup>9</sup> ACCC(2003), p22.

As discussed above, maintaining unregulated inter-capital routes and removing the declaration on the remaining transmission services would reduce market distortions associated with regulatory risk and would not result in inefficiently high prices being set. This, in turn, would have a positive effect on the extent and nature of competition in the wholesale and retail markets. Telstra and existing suppliers of transmission services would face improved incentives to upgrade their infrastructure and potential entrants would face more efficient build-buy decisions.

Table 6 summarises the impact on the Commission’s key criteria of maintaining unregulated inter-capital transmission and revoking declaration on the remaining transmission services.

**Table 6: Summary of impact on key criteria of unregulated transmission services**

Criteria	Comments
Any to any connectivity	No effect.
Efficient use of and investment in infrastructure	Revocation of declaration significantly reduces the risk of distorting efficient investment decisions. This will improve the incentive for current competitors to invest and innovate in their services and provide efficient build-buy incentives for potential new entrants.
Promotion of competition	Correcting incentives to invest in transmission services will promote competition in supply of transmission services and relevant downstream services. However, these improvements will likely have a limited impact given the current competitive nature of supply of transmission and the related downstream services.

Telstra does not believe that continued declaration of transmission services is appropriate. Given this, it is not relevant to discuss detailed issues surrounding pricing principles. If the Commission disagrees with Telstra’s analysis and suggests declaration continue, then Telstra would seek the opportunity to provide detailed comments on the appropriate pricing methodology.